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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

TRINOVA CORPORATION,
Petitioner,

v.

STATE OF MICHIGAN,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MICHIGAN

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QUESTIONS PRESENTED

The Michigan Single Business Tax Act imposes a tax, nominally on the "privilege of doing business" within the State, measured by the "value added" by the taxpayer to the goods and services it buys. The Act's "value added" tax base consists of the taxpayer's compensation paid to all its employees, in and out of state, its total depreciation and interest payments, and its profit. The Act determines the portion of this value deemed to have been added in Michigan by apportioning the tax base according to the three-factor formula of payroll, property, and sales that is widely used to apportion state income taxes. The application of that formula to petitioner, an Ohio company, attributed to Michigan 39 times more compensation than petitioner actually paid in Michigan, and 970 times more depreciation than petitioner actually incurred in Michigan.

The questions presented are:

1. Whether application to petitioner's value-added tax base of the three-factor formula used for apportioning state income taxes results in a tax on value actually added outside the state and produces a grossly distorted result, in violation of the Due Process and Commerce Clauses.

2. Whether the Michigan tax discriminates against out-of-state businesses in favor of in-state businesses by employing an apportionment formula that, in the vast majority of cases, irrationally reduces the tax base of the latter and increases the tax base of the former.

LIST OF PARTIES AND RULE 29.1 STATEMENT

Petitioner is the corporate successor to Libby-Owens-Ford Company, which commenced this action. Apart from the respondent, there were no other parties to the proceedings below. Petitioner's subsidiaries are these:

Aeroquip Automotive, Inc.

Aeroquip Gmbh

Aeroquip International, Inc.

Aeroquip Vickers de Brasil, S.A.

Custom Trim of Michigan, Inc.

Korea Vickers Systems Co., Ltd.

Microfuel Systems, Inc.

Sterling INOAC Co.

Toyo Joint Co., Ltd.

Vickers of India, Limited

Vickers Kawasaki Controls KK

Vickers Systems Gmbh
(Belgium, The Netherlands, and Switzerland)

Vickers Systems, Inc.

Zaverchand Gaekwad Private Ltd.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	1
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT	2
1. The Nature of a Value Added Tax	3
2. Michigan's Single Business Tax Act	5
a. The preapportioned tax base	6
b. The apportionment of value added to Michigan	8
3. The Tax Assessed Against Petitioner	9
4. The Jones & Laughlin Decision	10
5. The Proceedings Below	11
REASONS FOR GRANTING THE WRIT	14
I. THE USE OF THE THREE-FACTOR FORMULA FOR APPORTIONING PROFITS TAXES VALUE ADDED OUTSIDE THE STATE AND PRODUCES A GROSSLY DISTORTED RESULT	16
A. The SBT Wrongly Apportions Value Added That Can Be Precisely Allocated Elsewhere	16
B. The Three-Factor Formula Produces a Grossly Distorted Result	21
II. THE SBT DISCRIMINATES AGAINST OUT-OF-STATE BUSINESSES	24
CONCLUSION	28

TABLE OF AUTHORITIES

Cases: Page

Amerada Hess Corp. v. *New Jersey Taxation Division*, No. 87-453 (U.S. Apr. 3, 1989) 15, 21
American Trucking Ass'ns v. *Scheiner*, 483 U.S. 266 (1987) 24, 26
ASARCO Inc. v. *Idaho State Tax Comm'n*, 458 U.S. 307 (1982) 17
Boston Stock Exchange v. *State Tax Comm'n*, 429 U.S. 318 (1977) 24, 27
Butler Bros. v. *McColgan*, 315 U.S. 501 (1942) 8, 16, 21, 22
Caterpillar Inc. v. *Michigan*, Nos. 84-9664-CM and 87-11109-CM (Mich. Ct. Cl. opinion and order entered July 13, 1989, final judgment entered Aug. 11, 1989) 8
Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1977) 14, 15, 16, 20
Container Corp. v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) 3, 8, 13, 17, 21, 23
Exxon Corp. v. *Department of Revenue*, 447 U.S. 207 (1980) 8
General Motors Corp. v. *District of Columbia*, 380 U.S. 553 (1965) 23
Goldberg v. *Sweet*, 109 S. Ct. 582 (1989) 14
Hans Rees' Sons v. *North Carolina*, 283 U.S. 123 (1931) 16, 17, 18, 21
Jones & Laughlin Steel Corp. v. *Department of Treasury*, 145 Mich. App. 405, 377 N.W.2d 397 (1985), *leave to appeal and reconsideration denied*, 424 Mich. 895 (1986) 10
Maryland v. *Louisiana*, 451 U.S. 725 (1981) 27
Mobil Oil Corp. v. *Commissioner of Taxes*, 445 U.S. 425 (1980) 8, 19, 20
Mobil Oil Corp. v. *Department of Treasury*, 422 Mich. 473, 373 N.W.2d 730 (1985) 5, 19
Moorman Mfg. Co. v. *Bair*, 437 U.S. 267 (1978) .. 8, 17, 18, 23
National Bellas Hess, Inc. v. *Department of Revenue*, 386 U.S. 753 (1967) 5

TABLE OF AUTHORITIES—Continued

Page

Norfolk & Western Ry. v. *Missouri State Tax Comm'n*, 390 U.S. 317 (1968) 16, 18
Tyler Pipe Indus. v. *Department of Revenue*, 483 U.S. 232 (1987) 27
Underwood Typewriter Co. v. *Chamberlain*, 254 U.S. 113 (1920) 17
Westinghouse Elec. Corp. v. *Tully*, 466 U.S. 388 (1984) 27

Constitution and Statutes:

U.S. Const. art. I, § 8, cl. 3 2
U.S. Const. amend. XIV, § 1 2
28 U.S.C. § 1257(a) (1988) 1
Mich. Comp. Laws § 208.9 (1979) 7
Mich. Comp. Laws § 208.31 (1979) 9, 10
Mich. Comp. Laws § 208.45 (1979) 8
Mich. Comp. Laws § 440.2401(2)(a) (1979) 22
1987 Mich. Pub. Act 39 14
Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 336 (1957) 8

Secondary Materials:

Analysis of the Michigan Single Business Tax, Taxation and Economic Policy Office, Michigan Department of the Treasury, Table 4, p. 27 (Jan. 1985) 7
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Haughey, *The Economic Logic of the Single Business Tax Act*, 22 Wayne L. Rev. 1017 (1976) .. 3, 16, 24
Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 Nat'l Tax J. 487 (1968) 17
Kleine, *The Michigan Single Business Tax: A Different Approach to State Business Taxation*, Advisory Commission on Intergovernmental Relations (1978) 3-4, 24

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MICHIGAN

OPINIONS BELOW

The opinion of the Supreme Court of Michigan (App. 1a) is reported at 433 Mich. 141, 445 N.W.2d 428 (1989). The order of the Supreme Court of Michigan denying rehearing (App. 29a) is reported at 433 Mich. 1203 (1989). The opinion of the Michigan Court of Appeals (App. 30a) is reported at 166 Mich. App. 656, 421 N.W.2d 258 (1988). The opinion and order of the Michigan Court of Claims (App. 42a) is unreported.

JURISDICTION

The judgment of the Supreme Court of Michigan was entered on August 21, 1989. Petitioner's timely petition for rehearing was denied on October 16, 1989. (App. 29a.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Constitution, Amend. XIV, § 1 provides: "[N]or shall any state deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the Constitution, Art. I, § 8, cl. 3 provides: "The Congress shall have Power to regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

Relevant portions of the Michigan Single Business Tax Act, Mich. Comp. Laws § 208.1 *et seq.*, are set forth at App. 59a-62a.

STATEMENT

For a multistate taxpayer with business activities in Michigan, the Michigan Single Business Tax Act establishes a "value-added" tax measured by the value that the taxpayer is regarded as having added, within the state, to the selling price of its final products. The major components of added value are the costs to the business enterprise of labor (compensation costs) and capital (depreciation and interest costs). The Michigan statute taxed petitioner, an Ohio corporation, by determining the value purportedly added in Michigan through an apportionment formula that attributed to Michigan 3,900% more compensation than petitioner actually paid in the State, and 97,000% more depreciation than petitioner actually incurred in the State. Petitioner contends that the Act violates the Due Process and Commerce Clauses because, as applied to Petitioner, the tax is imposed upon value added almost entirely outside of Michigan, and because it impermissibly discriminates against out-of-state corporations.

Notwithstanding the profoundly different characteristics of a value-added tax from an income tax, the Michi-

gan Supreme Court treated the case as if it were just another income tax case. It assumed without discussion, and in our view wrongly, that individual elements of value added, like elements of corporate income, cannot accurately be traced to the state in which they are generated, and it endorsed without analysis, again in our view wrongly, the use of the three-factor property, payroll, and sales formula that is typically used for apportioning net income. On that footing it concluded that the tax assessed against petitioner was not wholly disproportionate to petitioner's business activity within the State, and was accordingly constitutional. The Court did not address petitioner's additional claim that the tax is discriminatory.[1]

"Various aspects of state tax systems based on the 'unitary business' principle and formula apportionment have provoked repeated constitutional litigation in this Court." *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 163-64 (1983) (citing cases). So far as we know, however, the Court has never considered a value-added tax. This kind of tax is not common in this country and it is necessary to understand how it differs from an income tax to appreciate why a constitutional analysis good for one is not good for the other.

1. The Nature of a Value Added Tax.

The tax may be easiest understood if it is assumed to have been adopted by a state to apply to a taxpayer which adds all the value to its product within the taxing state.[2] With respect to a final product or service that is

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[1] Behind this case in the Michigan courts lie hundreds of other cases, with well over $100 million at stake, brought by taxpayers most of whom, like petitioner, are out-of-state companies whose principal business activity in Michigan consists of marketing. See App. 74a.

[2] See generally Haughey, *The Economic Logic of the Single Business Tax*, 22 Wayne L. Rev. 1017 (1976); Kleine, *The Michigan Single Business Tax: A Different Approach to State Business*

delivered to the ultimate consumer, portions of the value of that product or service have been contributed by each of the several enterprises in the chain of corporations through whose hands it may have passed in the course of production. For example, a clothing manufacturer purchases material and through the use of its labor and capital equipment fabricates various articles of clothing. The product, a suit or a dress, say, has a value greater than the materials purchased. That value is attributable to the cost of the labor and capital and the value of the entrepreneurial effort—reflected in profit—contributed by the manufacturer.

The process continues through the wholesaler and on to the retailer who makes the final sale to the consumer. The tax is imposed on the value added by each company in the chain. In the aggregate it is imposed on the value of the final company's product or service (*e.g.*, the retail price of the dress), which will be the sum of the values added by each company along the way. Of course in some cases there may be only one taxpayer in the chain while in others there may be many. In every case the total tax base, whether attributed to one taxpayer or among many, is theoretically equal to the price paid by the consumer for the final product.

As we explain further below, the Michigan statute, like the example just given, starts from the premise that the value contributed by a taxpayer comes from three principal sources—first from work done by its employees, second from the portion of its capital plant that is consumed during the applicable period, and third from its profit, which compensates it for the entrepreneurial skills that have contributed to the final product. The first two items are easily quantified. The total compensation paid by the taxpayer represents the value of the labor contribution. The amount of depreciation of its capital as-

Taxation, Advisory Commission on Intergovernmental Relations (1978).

sets and the interest paid to others represents the capital contribution. Determination of the third item, profit, is more complex but it too may be ascertained. The sum of the three items, in addition to measuring the value added by the taxpayer, also becomes, in the case of a state tax applied to a company whose activities are entirely in one state, the tax base to which the tax rate is applied.

But complexities arise from the application of Michigan's statute to out-of-state enterprises. To be sure, a taxpayer that makes substantial sales to consumers within the state but has no employees or engages in no other business activities within the state may escape tax altogether.[3] But it is different when such a taxpayer establishes a taxable presence within the state through a few employees who support its sales efforts and perform modest services for its customers. That, indeed, is an accurate description of petitioner. Most of its business activities take place entirely in Ohio. In 1980 the total compensation paid to its employees was $226,356,271; of that amount $511,774, or 0.2%, was paid to its 14 employees in Michigan. App. 54a. Its depreciation amounted to $23,262,909; the depreciation of its Michigan assets was $2,152, or 0.009%. App. 55a. Petitioner suffered a net loss in that year, and so no part of the value it added to its products was attributable to profit.

We turn now to a fuller description of Michigan's value-added tax.

2. Michigan's Single Business Tax Act.

Michigan's Single Business Tax ("SBT") has been characterized by the Michigan Supreme Court as a consumption-type value added tax, *Mobil Oil Corp.* v. *Department of Treasury*, 422 Mich. 473, 373 N.W.2d 730 (1985), reflecting the fact that the tax is imposed pri-

[3] Cf. *National Bellas Hess, Inc.* v. *Department of Revenue*, 386 U.S. 753 (1967).

marily upon the value added to the goods and services purchased by the taxpayer through the consumption of capital and labor furnished by the taxpayer. In broad outline, and as applied to a taxpayer engaged in business within and without Michigan, the tax is calculated in essentially two steps. First a preapportionment tax base is established. Then the amount of value considered to have been added in Michigan is computed by means of the three-factor formula commonly used to apportion state income taxes, and, after certain other adjustments, the tax rate is applied to that amount.

a. *The preapportioned tax base.* Michigan computes the tax base by looking first to the activities of the taxpayer nation-wide, without regard to where they are conducted or the extent to which the activities are carried on within Michigan. The largest component of the tax base consists of compensation. The Act requires the taxpayer to include the total compensation paid to all employees, without regard to their locale or functions. Compensation includes, in addition to wages and bonuses, the value of fringe benefits not paid directly to employees, such as retirement plan contributions, health and welfare plan expenditures, and unemployment and social security taxes.

To compensation is added (to the extent they were deducted in arriving at federal taxable income) all depreciation, amortization, or write-offs of the cost of tangible assets, as well as interest, dividends, and royalties paid by the taxpayer. App. 11a. This component of the tax base reflects value added through the use of money or property in producing the taxpayer's goods or services.

Profit, called "busines income" by the SBT, the third item included in the aggregate value added, involves, as stated above, a more complex computation. Presumably for ease of administration and to reduce the need for verification, the SBT starts with the reported federal taxable net income. This is increased by certain amounts that are usually deducted in arriving at federal taxable

income but are regarded by the SBT as not appropriately deducted in computing annual business income, such as state income taxes paid, SBT taxes paid, and income on state debt obligations other than those of Michigan. On the other hand, investment income, including dividends, interest, and royalties received by the taxpayer, are deducted to the extent they were included in arriving at federal taxable income. App. 11a.[4]

These adjustments are often made in computing net income under state corporate income tax statutes, although it is instructive to note that investment income is deducted in the latter case because it is generally allocated to the domiciliary state rather than apportioned, whereas it is deducted from the tax base under a value-added tax because it does not represent any value added by the taxpayer to its products or services.

The profit component of the tax base is generally not quantitatively significant. The Michigan Department of Treasury has determined that, for all businesses subject to the tax, profit makes up less than 6% of the tax base. Compensation comprises 77%, and the remainder consists of other items, such as depreciation and interest.[5] There may of course be individual departures from the average—a capital intensive business, for example, would have a higher amount of depreciation and interest and a lower amount of compensation. Nevertheless, the SBT, like any other value-added tax, is essentially a tax on compensation paid and capital consumed during the taxable year.

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[4] There are other adjustments not mentioned here because they are irrelevant to the issues presented. See Mich. Comp. Laws § 208.9 (1979).

[5] *Analysis of the Michigan Single Business Tax*, Taxation and Economic Policy Office, Michigan Department of the Treasury, Table 4, p. 27 (Jan. 1985). Petitioner relied on and made this analysis available to the courts below. *E.g.*, Brief on Appeal in the Michigan Supreme Court, filed July 8, 1988, pp. 7-8 & n.2.

b. *The apportionment of value added to Michigan.* Once the tax base is established it is apportioned to Michigan according to a three-factor formula which weights payroll, property, and sales equally. Mich. Comp. Laws § 208.45 (1979). The formula is essentially the same as the familiar three-factor formula embodied in the Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 336 (1957), which the Court has considered on numerous occasions in recent years.[6] It assumes that payroll, property, and sales contribute relatively equally to the production of income. See *Butler Bros.* v. *McColgan*, 315 U.S. 501, 507 (1942). Michigan has chosen the three-factor formula to apportion value added even though, as discussed below, sales make a negligible contribution to value added as compared to compensation and depreciation.

From the apportioned tax base the taxpayer is permitted to subtract an amount reflecting capital acquisitions (the Capital Acquisition Deduction, or "CAD"), and another amount designed to adjust for high labor compensation costs.[7] Further deductions are allowed for

[6] See, *e.g.*, *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983); *Exxon Corp.* v. *Department of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 (1980). "The three-factor formula yields a percentage representing an average of three ratios: property within the State to total property, payroll within the State to total payroll, and sales within the State to total sales." *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 270 n.3 (1978).

[7] The CAD reflects the value added concept that "profit" should be the amount retained after expenditures for capital assets, even though this is not the generally accepted accounting definition and such expenditures are not deducted in arriving at federal taxable income. The Michigan Court of Claims recently struck down the CAD as unconstitutional on the ground that it impermissibly discriminated against out-of-state businesses because it operated to favor businesses with all or most of their operations in Michigan. *Caterpillar Inc.* v. *Michigan*, Nos. 84-9664-CM and 87-11109-CM (opinion and order entered July 13, 1989, final judgment entered Aug. 11, 1989), appeal pdg., Mich. Ct. App. No. 119584.

specified businesses. Tax at the rate of 2.35% is then imposed on the resulting "adjusted tax base." Mich. Comp. Laws § 208.31 (1979).

3. The Tax Assessed Against Petitioner.

This case was decided by the courts below on the basis of the parties' Stipulated Facts. App. 52a-58a. The chart below, reflecting those facts, shows, in the left-hand column, the components of petitioner's 1980 tax base ($221,125,319). The right-hand column shows the amount of the tax base apportioned to Michigan by the application of the three-factor property, payroll, and sales formula.

	Tax Base	Apportioned Tax Base (8.9717%)
Compensation	226,356,271	20,308,006
Depreciation	23,262,909	2,087,078
Interest, Dividends and Royalties Paid	22,908,950	2,055,322
Adjusted U.S. Taxable Income (Loss)	(42,466,114)	(3,809,932)
Subtract: Dividends, Interest & Royalties Received	(9,486,223)	(851,076)
Other additions	549,526	49,302
Tax Base	$221,125,319	$19,838,700
Apportionment		
Property Factor	.0930%	
Payroll Factor	.2328%	
Sales Factor	26.5892%	
Average Factor	8.9717%	
Apportioned Tax Base	$ 19,838,700 (221,125,319×8.9717%)	

As the chart shows, petitioner's compensation apportioned to Michigan was $20,308,006. Yet actual compensation paid to employees performing services in Michigan was only $511,774. App. 54a. Hence petitioner's apportioned Michigan compensation overstated its actual Michigan compensation by 39 times, or 3,900%. Petitioner's

apportioned Michigan depreciation was $2,087,078 compared to its actual depreciation on property located in Michigan of $2,152. App. 55a. Hence petitioner's apportioned Michigan depreciation was overstated by 970 times, or 97,000%.

Petitioner's apportioned tax base of $19,838,700 was adjusted by subtracting the Capital Acquisition Deduction and by the reduction allowed to compensate for high labor compensation costs, yielding an adjusted tax base of $12,492,671 and a 1980 tax, at 2.35%, of $293,578 before credits.[8]

4. The Jones & Laughlin Decision.

In 1985 a panel of the Michigan intermediate court of appeals ruled that a taxpayer conducting business both within and without Michigan, who in all relevant respects was similarly situated to petitioner, was entitled to relief under § 69 of the Act. That so-called "relief provision" permits a taxpayer, when the apportionment provisions of the Act do not fairly represent the extent of its business in Michigan, to petition for use of another method of apportionment to effect an equitable allocation and/or apportionment of the tax base. *Jones & Laughlin Steel Corp.* v. *Department of Treasury*, 145 Mich. App. 405, 377 N.W.2d 397 (1985), *leave to appeal and reconsid. den.*, 424 Mich. 895 (1986). See App. 63a-72a.

Like petitioner, the taxpayer in that case had a tax base comprised almost entirely of compensation; its actual compensation paid in Michigan could be determined accurately; and application of the statutory formula resulted in an apportionment of compensation to Michigan

[8] The statutory adjustment for high labor costs, found in Mich. Comp. Laws § 208.31(4), permits an SBT taxpayer a deduction to the extent that its compensation divided by its tax base exceeds 63%. See App. 13a, n.13.

that was multiples higher than the amounts directly allocable to the state. The court therefore allowed the taxpayer to apportion its tax base in an alternative fashion under § 69, namely, by excluding compensation from the tax base, applying the three-factor formula to the remaining tax base, and adding to that amount the actual amount of compensation directly allocable to Michigan. The decision was not based on constitutional grounds; rather, the court considered § 69 to provide relief whenever the results reached under the otherwise applicable statutory provisions were found to be unfair. App. 67a-68a, 71a.

5. The Proceedings Below.

Relying on *Jones & Laughlin*, petitioner requested § 69 relief and filed an amended tax return for 1980 seeking a refund. App. 7a. The Department of Treasury denied the request. App. 8a. Petitioner then sued, and prevailed, in the Michigan Court of Claims. App. 8a-9a. A different panel of the appellate court, however, rejected *Jones & Laughlin*'s interpretation of § 69 and reversed. App. 9a. The case then went to the Michigan Supreme Court.[9]

In that court the State acknowledged that out-of-state manufacturers "incur the majority of their wage costs

[9] Petitioner's complaint in the Court of Claims at ¶ 13 alleged that the tax as applied to it violated the Due Process and Equal Protection Clauses because of the misattribution of petitioner's tax base. That court did not reach any constitutional issue, ruling in petitioner's favor on the basis of its construction of § 69 of the SBT. In the Michigan Court of Appeals petitioner argued that the SBT as applied to it violated the Due Process and Commerce Clauses, Brief on Appeal, filed Dec. 21, 1987, at 20-26, although, as noted above, that court, too, based its ruling solely on the SBT. In the Michigan Supreme Court petitioner argued that, unless relief were available under § 69, petitioner would be subject to unconstitutional taxation of extraterritorial business activity in violation of both the Due Process and Commerce Clauses. Brief on Appeal, filed July 8, 1988, pp. 10-27.

outside of Michigan" and "their depreciation expense is related to factories which are outside of Michigan." It recognized that "[u]nder the *Jones & Laughlin* rationale, these expenses * * * are assigned to the out-of-state location." Defendant-Appellee's Brief on Appeal, filed Aug. 5, 1988, at 2. It also recognized that, if Michigan forthrightly imposed a tax directly on compensation, it "would apply to a tax subject so inherently locale-specific as to require specific allocation" to the state in which the compensation was paid. *Id.* 31. But it argued that the Michigan tax falls, not on compensation, nor depreciation, but on "value added," which is appropriately apportioned by the three-factor formula that is used to apportion net income for purposes of state income taxes. *Id.* 19-26.

The Michigan Supreme Court upheld the tax. It said that the Act taxes "business activity," which includes "the complete range of entrepreneurial activities of which compensating employees is but one part." App. 22a. "Consequently," the Court said,

> "to conclude that a taxpayer's business activity is not fairly apportioned because a single component of that activity, when examined by geographical accounting, is not accurately reflected under the statutory apportionment scheme belies the very definition of business activity." *Id.*

Like the State, however, the Michigan Supreme Court had to acknowledge that the "single component" at issue—compensation—accounted for "a substantial portion of the tax base in most businesses", and the entire portion in petitioner's case. *Id.* But the Court refused to consider whether compensation or depreciation can be clearly identified on a geographical basis—or, more precisely, whether the value added by those elements of added value can be thus identified, leaving the profit element to be apportioned. Instead it simply ruled that apportionment of the aggregate value-added tax base was constitutionally acceptable, relying principally on an income tax case, *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159, 164 (1983).

There this Court held that California was not required, in imposing its income tax on a unitary business with foreign subsidiaries, to account separately for income from the subsidiaries because "separate [geographical] accounting * * * may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" 463 U.S. at 181 (inner quotations omitted; bracketed material in original).

The Michigan Supreme Court adopted that analysis and without discussion assumed that "the failings of separate accounting" in income tax cases would necessarily bedevil and require apportionment in value added cases as well. App. 23a, n. 24. The Court thus accepted the income tax apportionment formula and concluded that the tax assessed against petitioner, when judged against its overall "business activity" conducted in the state, was constitutional:

> "Trinova's actual Michigan compensation was $511,774, and its actual property as reflected in its depreciation expense was $2,152. While these figures obviously represent a very small percentage of Trinova's total business activity, they are offset by its Michigan sales figure of $103,081,354. When viewed as a whole, we believe the average ratios of Trinova's payroll, property, and sales 'actually reflect a reasonable sense of how [its Michigan business activity was] generated,' clearly satisfying the constitutional requirements of internal and external consistency." App. 24a-25a (bracketed material in original; footnote omitted).

The Court did not explain, in holding that petitioner's receipt of $103,981,354 for products it delivered in Michigan "offset" its Michigan compensation and depreciation figures, what value to petitioner's product was added by those deliveries. It did not consider, for example, whether the Michigan sales were the result of marketing and sales efforts made by petitioner's employees (elements of added value already reflected in compensation) or whether they were the result of the consumption of capital (already reflected in depreciation). Rather, the Court seemed to assume that the fact of delivery in Michigan of goods worth $103,981,354 meant that $103,981,354 worth of value to the sold products was actually added in Michigan. The bizarre result of the Court's mechanical application of an income tax apportionment formula to a value-added tax base was that almost 10% of petitioner's value adding activities were attributed to Michigan, even though virtually none of those activities was conducted in Michigan.[10]

REASONS FOR GRANTING THE WRIT

A state tax on multistate corporations must pass "the four-pronged test originated in" *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). *Goldberg* v. *Sweet*, 109 S. Ct. 582, 587 (1989). The tax will survive constitutional challenge if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." 430 U.S. at 279. This Court "repeatedly [has] applied this principle in subsequent cases" (*Amerada Hess Corp.* v. *New Jersey Taxation Division*, No. 87-453, Slip op. at 6 (Apr. 3, 1989)), but never to a value-added tax.

[10] In 1987 the State enacted 1987 PA 39, which amended the Act effectively to overrule *Jones & Laughlin* by providing that the apportionment provisions of the Act shall "fairly represent business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of the tax base such as depreciation, compensation, or income * * *." App. 75a. As we have seen, the Michigan Supreme Court's decision in this case did overrule *Jones & Laughlin* and construed the *preamended* SBT to preclude examination of the components of the tax base. Hence the decision makes the amendment redundant. Accordingly, we believe that, if this Court were to rule that the SBT as construed below is unconstitutional, the amendment could not save it. In any event, the Court below made no determination regarding the amendment. See App. 27a, n.29.

The Michigan SBT as construed by the Michigan Supreme Court fails the second and third prongs of the *Complete Auto* test. As we show below, the tax is not fairly apportioned because, with respect to its most significant components—compensation and depreciation—it should not be apportioned at all. That is because the value added by those components is capable of precise location inside and outside the State. Moreover, even if it were appropriate to apportion the tax base, the formula chosen by the State—and in particular the inclusion of the sales factor—yields an unconstitutionally distorted result. There is no theoretical or practical justification for including a sales factor in the apportionment formula, since no value is added to the taxpayer's goods by the mere act of delivering them into the State. The manner in which the tax base is constructed and the economic justification for the tax combine to show that only a trivial addition of value can be attributed to this activity. Yet the inclusion of a sales factor apportions to Michigan compensation and depreciation costs which, as the State has stipulated, exceed petitioner's actual Michigan costs by 3,900% and 97,000%, respectively.

We also show below that the tax is discriminatory, and fails the third prong of the *Complete Auto* test, because it prefers taxpayers whose labor force and physical plant are located within the state to taxpayers whose labor force and plant are located without the state. Use of the sales factor causes compensation and depreciation of

Michigan manufacturers to be wrongly exported out of the state (and out of the SBT tax base) while wrongly importing into the state (and into the tax base) the compensation and depreciation of out-of-state taxpayers.

The outcome of this case will affect hundreds of other multistate corporate taxpayers in over 400 pending cases with well over $100 million in the balance. It will influence the actions of other States in determining whether to adopt a value added tax, which produces revenue regardless of corporate profits.[11] For those reasons, and because the decision below is fundamentally unsound as a matter of constitutional law and warrants correction, the Court should hear this case.

I. THE USE OF THE THREE-FACTOR FORMULA FOR APPORTIONING PROFITS TAXES VALUE ADDED OUTSIDE THE STATE AND PRODUCES A GROSSLY DISTORTED RESULT

A. The SBT Wrongly Apportions Value Added That Can Be Precisely Allocated Elsewhere.

The fair apportionment prong of *Complete Auto* restates the settled rule that extraterritorial taxes violate the Due Process and Commerce Clauses. *E.g. Norfolk & Western Ry.* v. *Missouri State Tax Comm'n*, 390 U.S. 317 (1968); *Butler Bros.* v. *McColgan*, 315 U.S. 501, 506 (1942); *Hans Rees' Sons* v. *North Carolina*, 283 U.S.

[11] Michigan's switch to the value added tax had several goals, among them (a) "to increase the stability of state business tax revenues over the business cycle * * * by abandoning profits as the principal business tax base", (b) "to establish a neutral tax system with each business paying taxes in proportion to its economic size", and (c) "to reduce the heavy burden of taxation on capital in Michigan [and thereby stimulate] job-creating capital investments in Michigan and expansion of demand for the goods and services of local market industries." Haughey, *supra*, at 1021-1022. These anticipated benefits may recommend a value-added tax to states other than Michigan.

123, 134 (1931) (state may not tax "profits which are in no just sense attributable to transactions within its jurisdiction."). In the case of an income-based tax, a state may not constitutionally " 'tax value *earned* outside its borders.' " *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 164 (1983) (emphasis added), *quoting ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). There can be no reason for a different constitutional rule for a value-added tax.[12] The SBT, however, taxes value that is *added* outside its borders. The reason, as we shall see, lies chiefly in the State's use of the three-factor formula for apportioning profit in income tax cases.

Formulary apportionment is justified by the conceptual and practical difficulties that preclude a precise determination of where the profit of a unitary multistate corporation is earned. As Justice Powell has explained, apportionment "owes its existence to the fact that with respect to a business earning income through a series of transactions beginning with manufacturing in one State and ending with a sale in another, a precise—or even wholly logical—determination of the State in which any specific portion of the income was earned is impossible." *Moorman Mfg.*, *supra*, 437 U.S. at 286 (Powell, J., dissenting).[13]

There is no justification for apportionment, however, when the geographic locus of a tax base can be identified

[12] "[I]f an apportionment method results in the taxation of a larger portion of the income, capital stock, property *or other tax base* than is properly attributable to the state, under established legal doctrine, the taxpayers' rights, protected by the Due Process Clause, have been infringed." Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 Nat'l Tax J. 487 (1968) (emphasis added; footnote omitted).

[13] See also *ASARCO Inc.*, *supra*, 458 U.S. at 316-317; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 120-121 (1920).

with precision. Thus there is no warrant for apportioning an ad valorem tax on real or immobile personal property, and no taxing jurisdiction in the country attempts to do so. Because the geographic situs of the property can be identified with precision, any attempt to determine the tax base by reference to a formula (containing factors other than the property itself) would necessarily lead to geographical misattribution of the tax base.

Furthermore, even when apportionment is generally an acceptable method of determining the geographic location of a tax base, a taxpayer may successfully challenge the application of a formula to its tax base if it can demonstrate that the formula leads to "a grossly distorted result." *Norfolk & Western Ry., supra*, 390 U.S. at 326. Thus, if the taxpayer can show what percent of income "actually had its source in the State", and the State's formula apportions to itself a significantly greater amount, the tax is unconstitutional. *Moorman Mfg. Co., supra*, 437 U.S. at 274, describing *Hans Rees' Sons, supra.*

The SBT, in adopting a formulary apportionment approach, wrongly assumes that the value added by the taxpayer's business activities cannot be specifically attributed to the states in which it conducts those activities, and, in so assuming, has in this case produced "a grossly distorted result." The assumption is wrong because the Act itself identifies the activities that add value, and the value that the two principal elements add can be located precisely where those activities themselves occur. In this respect the components of added value are conspicuously unlike the abstruse and elusive elements of profit that justify apportionment of net income.

As we have seen, a business adds value to its ultimate product principally through the efforts of its employees (reflected in their compensation), the dedication of its capital (reflected in depreciation and interest paid), and the entrepreneurial talents of its management (reflected,

one may hope, in profit). The SBT explicitly recognizes these "inputs" to added value by constructing a tax base reflecting compensation plus depreciation plus an adjusted "business income" (*i.e.*, profit).

With the exception of profit, which is an appropriate subject for apportionment for the same reasons it is apportioned in income tax cases, these inputs of added value are demonstrably different from the "factors of profitability" that contribute to a multistate corporation's income—such as "functional integration, centralization of management, and economies of scale." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 438 (1980). Those abstract and conceptual factors confound the effort "to characterize the income of the business as having a single identifiable 'source.'" *Id.* The compensation and depreciation components of added value, by contrast, are concrete and can be located precisely. As the Michigan Supreme Court has said, the SBT taxes "the use of the resources of society". *Mobil Oil Corp. v. Department of Treasury, supra*, 422 Mich. at 494, 373 N.W.2d at 740. Those resources, petitioner's labor and petitioner's plant, were used where they were consumed—in this case almost entirely in Ohio. Their use added value to goods ultimately delivered in Michigan, but the delivery itself did not. The value had been added before and in Ohio, when and where the labor and plant were consumed. And the State itself has conceded that a tax on compensation —which, in petitioner's case, describes the SBT perfectly —would be required to be allocated to the state in which the compensation was paid. See p. 12, *supra*.

The Michigan Supreme Court reached its contrary result by stating that what Michigan really taxes is not value added, but instead an amorphous and indivisible concept called "business activity," which is no more geographically identifiable than the net income that most states tax under their corporate income taxes, and hence equally subject to apportionment. See p. 12, *supra*. But

this facile analysis cannot withstand constitutional scrutiny. As this Court has made clear, the touchstone of constitutional analysis of state taxes is "the practical effect of a challenged tax" (*Mobil Oil Corp. v. Commissioner of Taxes*, *supra*, 445 U.S. at 443) and "economic realities." *Complete Auto*, *supra*, 430 U.S. at 279. Accordingly, "[t]here is no economic consequence that follows necessarily from the use of the particular words 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect." 430 U.S. at 288. It is the same with the phrase "business activity": its use cannot obscure the question of forbidden effect. As we have shown above, the distinguishing feature of a value added tax such as Michigan's is that it is possible to identify precisely the components of the tax base, and to locate precisely the principal ones—compensation and depreciation. The Michigan Supreme Court cannot escape that conclusion by an *ipse dixit* which is simply inconsistent with the facts.[14]

The misguided assumption underlying the SBT's apportionment provisions—that compensation and depreciation cannot be precisely identified on a geographic basis

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[14] As two economists have written:

> "The standard three-factor formula used for determining what fraction of a multi-state firm's value added should be taxable under the SBT is a cumbersome method of arriving at the wrong answer. Since value added consists of payments to labor and to capital, whose location in both cases is relatively unambiguous, there is no reason why value added in Michigan should not be measured directly. Instead, the apportionment formula measures it indirectly and incorrectly * * * by giving weight to sales, which do not measure the employment of a factor of production, and hence are not a component of value added."

R. Barlow and J. Connell, Jr., *The Single Business Tax*, Michigan's Fiscal and Economic Structure, U. Mich. Press, 673 (Brazer, H., ed. 1982)

—has produced a constitutionally intolerable result in this case. In *Hans Rees' Sons*, *supra*, the state's apportionment formula attributed 85% of the taxpayer's income to North Carolina, as compared to a separate accounting analysis which attributed at most 21.7%. It was "the more than 250% difference which led [the Court] to strike down the [North Carolina] tax." *Container Corp. supra*, 463 U.S. at 184. Yet the SBT has apportioned $20,308,006 in compensation to Michigan when actual compensation to Michigan employees was $511,774, a difference of 3,900%. And the SBT has apportioned $2,087,078 in depreciation to Michigan when actual Michigan depreciation was $2,152, a difference of 97,000%. These figures are far beyond "the substantial margin of error inherent in any method" of apportioning income of a multistate company, *id.*, and condemn the tax.

B. The Three-Factor Formula Produces a Grossly Distorted Result.

Even if, contrary to the foregoing, the State was right in apportioning rather than allocating petitioner's compensation and depreciation, the result is unconstitutional because the apportionment to Michigan of the value added by petitioner's consumption of labor and capital is "'out of all appropriate proportions to'" petitioner's business transacted in Michigan and has "'led to a grossly distorted result.'" *Container Corp., supra*, 463 U.S. at 170. These results are caused by the State's unthinking adoption of the three-part formula used to apportion income taxes.

The three-factor property, payroll, and sales formula, which is now "'something of a benchmark against which other apportionment formulas are judged'" (*Amerada Hess Corp., supra*, Slip op. at 7), was approved by the Court in *Butler Bros., supra*, on the ground that those three factors—

> "reflect 'the relative contribution of the activities in the various states to the production of the total unitary income,' so as to allocate to California its just proportion of the profits earned by appellant from this unitary business." 315 U.S. at 509.

These things cannot be said of the formula as applied to value added, for the chief reason that the sales factor does not in fact or theory make remotely the same contribution to value as payroll and property. Because of that its inclusion in the formula can lead to stunning distortions, as it has here, for the following reasons.

The sales factor in the formula as applied to petitioner in fact measures deliveries in the state, not actual sales.[15] There is no value added by the delivery *per se*. Any value added associated with the delivery is to be found in the wages of the deliverers (if they are petitioner's employees), which is already accounted for in the payroll factor.[16] Yet, for a business like petitioner's, with large deliveries in the state but small amounts of actual compensation and depreciation—the major components of value added—the inclusion of the sales factor produces a grotesque misapportionment. Petitioner's payroll factor (Michigan payroll over total payroll) was .2328%. Its property factor was .0930%. Those two factors, reflecting the major portions of added value, average .1629%, a percentage which, when applied to petitioner's tax base of $221,125,319, yields an apportioned tax base of $360,213. When the sales factor of 26.5892% is added, however, the average jumps over 55 times to 8.9717%, and the apportioned tax base to $19,838,700.

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[15] Petitioner's shipments of goods to Michigan customers are shipped F.O.B. Ohio. Thus, under the Uniform Commercial Code, the transfer of title takes place in Ohio. Mich. Comp. Laws § 440.2401(2)(a) (1979).

[16] If the deliveries are made by an independent transportation company, the employees' wages will be reflected in the compensation component of the value added tax base of that company.

The distortion would remain even if title passed in Michigan and the sales factor did measure sales rather than deliveries. Sales can add value in only two ways—through the compensation paid to employees engaged in sales efforts, and through profit to the extent that the sales include a markup. But the value added by compensation to salespersons will already be in the tax base and apportioned through the payroll factor and should not be duplicated by the sales factor. The remaining value added—profit—generally accounts, as we have seen, for a minor percentage of total added value, and does not deserve equal footing with the major items of payroll and property. Indeed, in petitioner's case, since it suffered a loss, there was no value added in the form of profit whatsoever. Yet inclusion of the sales factor in the formula meant the difference between an adjusted tax base of $360,213 and $19,838,700.

This Court has declined to annoint any particular formula as, in the abstract, constitutionally required or forbidden. *E.g., Moorman Mfg., supra.* But it has been equally insistent that, whatever formula is chosen, it must be "fair", meaning among other things that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container Corp., supra*, 463 U.S. at 169. In the case of a value added tax, the factors must actually reflect a reasonable sense of how value is added. Yet here, as we have shown, they do not, because of the erroneous inclusion of the distorting sales factor.[17]

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[17] This Court has noted, albeit not in a constitutional context, that the three-factor formula "can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates. By contrast, the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor." *General Motors Corp.* v. *District of Columbia*, 380 U.S. 553, 561 (1965).

II. THE SBT DISCRIMINATES AGAINST OUT-OF-STATE BUSINESSES

"[T]he Commerce Clause prohibits a State from imposing a heavier tax burden on out-of-state businesses that compete in an interstate market than it imposes on its own residents who also engage in commerce among States." *American Trucking Ass'ns, Inc.* v. *Scheiner*, 483 U.S. 266, 282 (1987); *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 335 (1977). The SBT's compliance with this prohibition must be analyzed in light of its overall operation and purposes, for, "in its guarantee of a free trade area among States * * * the Commerce Clause has a deeper meaning that may be implicated even though state provisions * * * do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." *American Trucking*, *supra*, 483 U.S. at 282.

Before Michigan adopted the SBT it had an income tax which, of course, did not tax compensation but instead treated it as a deduction in arriving at the income tax base. In replacing the income tax with the SBT, the legislature "intended to reduce the heavy burden of taxation on capital in Michigan".[18] The decreased burden on capital intensive industries was expected to encourage more capital investment in Michigan and stimulate the state's economic growth—*i.e.*, "to promote the development and investment of business within Michigan." App. 73a (inner quotation and footnote omitted). But it also results in an "increase [in taxes] for firms in labor intensive industries."[19] More important, it does so in a manner that systematically reduces the tax base of businesses located principally within the state that sell their products elsewhere while systematically increasing the tax base of businesses located principally outside the state that sell their products in Michigan.

[18] Haughey, *supra*, at 1022. The intended and practical effect of the SBT is discussed in detail in Haughey, at 1021-1024. See also Kleine, *supra*, at 39-43.

[19] Haughey, *supra*, at 1022.

The SBT's systematic discrimination in favor of local and at the expense of out-of-state businesses is the inexorable consequence of the application of the familiar three-factor apportionment formula, with a sales factor, to a tax base comprised almost entirely of compensation and depreciation and interest. The point can be made with a simple example. Assume two businesses, a "Michigan business" and an "Ohio business," each with a total SBT tax base of $1,500,000, comprised, as Michigan's statistics tell us, of 77% compensation, 6% profit, and the remaining 17% of such items as depreciation and interest. If the Michigan business has 98% of its property and payroll in Michigan, and 60% of its sales in Michigan, application of the three-part formula will attribute 14.67% of its compensation outside the state.[20] If the Ohio business has 98% of its payroll and property in Ohio, but 40% of its sales in Michigan, the three-part formula will attribute 14.67% of its compensation to Michigan.[21]

Thus the Ohio business, with virtually none (only $23,100) of its compensation in Michigan, will be taxed on $169,439 of the value added by the labor of its employees. The Michigan business, with virtually all its compensation ($1,131,900) in Michigan, will have $169,439 of the value added by its labor attributed out of

[20] The arithmetic is: 98% payroll in Michigan plus 98% property in Michigan plus 60% sales in Michigan=256%, which divided by 3=85.33% attributed to Michigan, and the remaining 14.67% attributed out of state.

[21] Thus: 2% payroll plus 2% property plus 40% sales=44%, which divided by 3=14.67% attributed to Michigan.

state and *not* taxed in Michigan.[22] Thus for the Ohio business the formula attributes $146,339 *more* compensation to Michigan than it actually pays to its Michigan-based employees, while attributing for the Michigan business $146,339 *less* compensation to its Michigan employees than it actually pays those employees.[23] If we prolonged the example by figuring the formula's effect on the depreciation component of the tax base, we would find similar results. For both taxpayers the three-part formula not only attributes amounts to the wrong place, but also does so in a way that reduces the tax base for Michigan-based companies while increasing it for out-of-state companies.

This result brings the SBT squarely within the reach of this Court's decisions striking down other discriminatory state taxes. *American Trucking* held that Pennsylvania's flat taxes "discriminate against out-of-state vehicles by subjecting them to a much higher charge per mile traveled in the State" than the comparable charge on local vehicles. *Id.* at 290. The Court ruled that, since the taxes "impose a cost per mile on appellants' trucks that is approximately five times as heavy as the cost per mile borne by local trucks, the taxes are plainly discriminatory." *Id.* at 286. Michigan's SBT likewise discriminates against out-of-state businesses by imposing on them a far greater tax burden per dollar of actual value added

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[22] Calculated as follows: The compensation component (77%) of the $1,500,000 tax base is $1,155,000, of which 14.67% is $169,439. For the Ohio company, however, with only 2% of its payroll in Michigan, actual Michigan compensation would be $23,100 (2% of $1,155,000). For the Michigan company, with 98% of its payroll in Michigan, actual Michigan compensation would be $1,131,900 (98% of $1,155,000).

[23] For the Ohio business, the difference between actual compensation of $23,100 and attributed compensation of $169,439 is $146,339. For the Michigan company the figures are $1,131,900 of actual compensation and $985,561 of attributed compensation ($1,155,000 less $169,439), also yielding a difference of $146,339.

in Michigan than the tax imposes on taxpayers with their labor force and physical plant located principally within the state.

Similarly, in *Maryland* v. *Louisiana*, 451 U.S. 725, 757 (1981), the Court invalidated a Louisiana tax scheme on the ground that its "obvious economic effect * * * is to encourage natural gas owners involved in the production of [Outer Continental Shelf] gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other States." And *Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388 (1984), struck down a New York statute which provided a greater tax credit for export activity originating in, rather than out of, the state. The Court ruled that "[w]hether the [New York credit] diverts new business into the State or merely prevents current business from being diverted elsewhere, it is still a discriminatory tax * * *." 466 U.S. at 406. Like the defective taxes in those cases, the SBT, because of its reliance on an inappropriate apportionment formula, impermissibly pressures interstate businesses to shift their operations to Michigan. See *Tyler Pipe Indus.* v. *Department of Revenue*, 483 U.S. 232, 243 (1987); *Boston Stock Exchange*, *supra*, 429 U.S. at 329.

CONCLUSION

The petition for a writ of certiorari should be granted.

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January 16, 1990

APPENDIX

APPENDIX

MICHIGAN SUPREME COURT

Docket No. 82673

TRINOVA CORPORATION

v.

DEPARTMENT OF TREASURY

(Calendar No. 10)

Argued November 2, 1988 Decided August 21, 1989

Trinova Corporation, an Ohio-based corporation whose business activity in Michigan included $103,981,354 in sales, but only a small sales office, filed an amended tax return claiming a refund of its small business tax for 1980 and seeking permission to use an alternative method of apportionment under § 69 of the Single Business Tax Act similar to the method approved by the Court of Appeals in *Jones & Laughlin Steel Corp v Dep't of Treasury*, 145 Mich App 405 (1985). The requested tax-base apportionment would have resulted in a negative adjusted tax base, thereby reducing Trinova's tax liability to zero for 1980. Both the refund and apportionment relief were denied. Thereafter, Trinova brought an action in the Court of Claims against the Department of Treasury, seeking the requested apportionment relief and a refund of its claimed 1980 Single Business Tax overpayment. The court, Robert Holmes Bell, J., relying on *Jones & Laughlin*, ordered the refund on the basis of the alternative apportionment formula. The Court of Appeals, MAHER, P.J., and SHEPHERD and K. TERTZAG, JJ., reversed in an opinion per curiam, finding that relief un-

der § 69 was available only where application of the apportionment formula resulted in an unfair representation of the taxpayer's Michigan-based business activity taken as a whole, concluded that 1987 PA 39, which amended § 69 to restrict the availability of apportionment relief in response to *Jones & Laughlin*, was intended to apply retroactively, and remanded the case for further factual development and reconsideration in light of 1987 PA 39 (Docket No. 100641). The plaintiff appeals.

In an opinion by Justice BOYLE, joined by Chief Justice RILEY, and Justices BRICKLEY, CAVANAGH, ARCHER, and GRIFFIN, the Supreme Court *held:*

Apportionment relief under § 69 of the Single Business Tax Act may obtain upon a showing by the challenging party of clear and cogent evidence that the business activity attributed to the state is out of all appropriate proportion to the taxpayer's intrastate business activity or has led to a grossly distorted result.

1. The single business tax is a form of value added tax, although it is not a pure value added tax. Rather, it is a tax upon business activity. Its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan, not upon income. The tax is computed by determining the taxpayer's tax base, and then allocating the value earned to the state where the business activity of the taxpayer can be fairly attributed. Apportionment relief under § 69 may be obtained if the apportionment provisions of the act do not fairly represent the extent of the taxpayer's business activity in this state. The central purpose of any apportionment provision is to ensure that each state taxes only its fair share of an interstate transaction. To preserve the constitutionality of the act, § 69 allows the use of an alternate method of apportionment if the apportionment provisions result in an unconstitutional taxation of a unitary business.

2. Generally, a state may not tax value earned outside its borders. An apportionment formula must be fair under both the Due Process and Commerce Clauses. It must be internally and externally consistent, resulting in no more than one-hundred percent of the taxpayer's business activity being taxed, if all taxing jurisdictions employed the same formula, and must reflect a reasonable sense of how the business activity is generated. An apportionment formula will not be deemed unfair if it *may* result in taxation of some business activity that did not have its source in the taxing state. It will be held to be externally inconsistent only upon a showing by the taxpayer of clear and cogent evidence that the business activity attributed to the state is out of all appropriate proportion to the business transacted in that state or has led to a grossly distorted result. In *Jones & Laughlin*, the Court of Appeals erred in concluding that the apportionment provisions of the act failed to fairly represent the extent of the taxpayer's business activity because the formula distorted one element of the activity, in considering the filing of an amended return to be a petition for the purpose of securing relief under § 69, and in the approving an alternate apportionment formula without prior approval of the commissioner.

3. In this case, although the petitioner sought apportionment relief under § 69 on the ground that the act's apportionment formula failed to accurately represent its Michigan business activity, it was not shown by clear and cogent evidence that the statutory apportionment provisions attributed business activity to Michigan that was out of all proportion to the petitioner's business actually transacted in Michigan or has led to a grossly distorted result. Viewed as a whole, the apportionment reflects a reasonable sense of the petitioner's actual Michigan business activity, clearly satisfying the internal and external consistency requirements.

Affirmed with modification.

Justice LEVIN, writing separately, stated that this case, together with the several hundred other cases pending in the Court of Claims, should be remanded for a hearing on the factual issues adverted to in the briefs of the parties and the amici curiae and in the opinion of the Court.

166 Mich App 656; 421 NW2d 258 (1988) affirmed.

Jones & Laughlin Steel Corp v Dep't of Treasury, 145 Mich App 405; 377 NW2d 397 (1985) overruled.

TAXATION—SINGLE BUSINESS TAX ACT—APPORTIONMENT RELIEF.

Apportionment relief under § 69 of the Single Business Tax Act may obtain upon a showing by the challenging party of clear and cogent evidence that the business activity attributed to the state is out of all appropriate proportion to the taxpayer's intrastate business activity or has led to a grossly distorted result (MCL 208.69; MSA 7.588[69]).

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William H. Crabtree, General Motors Corporation (by *E. Alan Moorhouse*, of counsel), and Ford Motor Corporation (by *John M. Neberle*, of counsel) for Motor Vehicle Manufacturers Association of the United States, Inc.

OPINION OF THE COURT

BOYLE, J. In this case we are called upon to determine the proper standard for the granting of tax base apportionment relief § 69[1] of the Single Business Tax Act, MCL 208.1 *et seq.*; MSA 7.558(1) *et seq.*, when a taxpayer claims that the apportionment provisions of the act fail to fairly represent the extent of the taxpayer's business activity within this state. The Court of Appeals in *Jones & Laughlin Steel Corp v Dep't of Treasury*, 145 Mich App 405; 377 NW2d 397 (1985), lv den 424 Mich 895 (1986), determined that § 69 apportionment relief is appropriate when any one element of the taxpayer's business activity, as represented in its adjusted tax base, is not accurately reflected under the statutory apportionment formula, notwithstanding the fairness of the resulting apportionment. The *Jones & Laughlin* Court also approved of an alternate two-step apportionment/

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[1] In the event that the statutory apportionment provisions fail to "fairly represent the extent of the taxpayer's business activity in this state," § 69 provides that upon the petition of the taxpayer or insistence of the Commissioner of Revenue, an alternate method of apportionment may be used if reasonable and if approved by the commissioner.

allocation method [2] whereby the taxpayer's tax base was apportioned under the standard formula exclusive of the § 9 adjustment for compensation expense. The taxpayer's actual compensation expense was then directly allocated to determine the taxpayer's adjusted tax base. We are asked to review the propriety of this rule.

After due consideration, we reject the *Jones & Laughlin* rule. To determine whether the apportionment provisions of the act fairly represent the extent of a taxpayer's Michigan business activity a reviewing court or tribunal must first find, upon a showing of clear and cogent evidence by the challenging party, that the total business activity attributed to Michigan is out of all ap-

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[2] As part of the tax base computation, § 9(5) calls for the addition of compensation as defined in MCL 208.4(3); MSA 7.558(4)(3). See MCL 208.9(5); MSA 7.558(9)(5). Section 4(3) defines "compensation" as:

"Compensation" means all wages, salaries, fees, bonuses, commissions, or other payments made in the taxable year on behalf of or for the benefit of employees, officers, or directors of the taxpayers and subject to or specifically exempt from withholding under section 3401 of the internal revenue code. Compensation includes, on a cash or accrual basis consistent with the taxpayer's method of accounting for federal income tax purposes, payments to state and federal unemployment compensation funds, payments under the federal insurance contribution act and similar social insurance programs, payments, including self-insurance, for workmen's compensation insurance, payments to individuals not currently working, payments to dependents and heirs of individuals because of current or former labor services rendered by those individuals, payments to a pension, retirement, or profit sharing plan, and payments for insurance for which employees are the beneficiaries, including payments under health and welfare and noninsured benefit plans and payments of fees for administration of health and welfare and noninsured benefit plans. Compensation does not include discounts on the price of the taxpayer's merchandise or services sold to the taxpayer's employees, officers, or directors which are not available to other customers or payments to an independent contractor.

propriate proportion to the actual business transacted in this state or leads to a grossly distorted result. The *Jones & Laughlin* Court erroneously concluded that the apportionment provisions of the act failed to fairly represent the extent of the taxpayer's total business activity because the formula distorted *one* element of that activity.

We find greater wisdom in this Court of Appeals panel's rejection of the *Jones & Laughlin* rule: Since the final apportionment percentage is the *average* of three component percentages (property, payroll, and sales), it will in all cases be larger than at least one of the component percentages unless by fortuity all of the components are equal. Thus, the *Jones & Laughlin* rule transforms the § 69 relief provision into an all-purpose tax equity provision. We agree with this Court of Appeals panel and reject that construction of § 69. We affirm with modification the decision of the Court of Appeals reversing the Court of Claims and remanding this matter for further proceedings.

I

FACTS

Trinova is an Ohio-based corporation which manufactures and distributes automobile components nationwide. Its activity in Michigan is confined primarily to a small sales office employing fourteen office and clerical workers who solicit sales orders for Trinova's glass division and who also provide liaison with its Michigan customers. For the tax year 1980, Trinova's sales in Michigan totaled $103,981,354, constituting over twenty-six percent of its total sales. Under the act, Trinova was assessed a tax of $293,528 which it paid.

Approximately one month after the Court of Appeals decided *Jones & Laughlin*, *supra*, Trinova timely filed with the state an amended tax return claiming a refund of its single business tax for the year 1980. Trinova also

sought permission to use an alternative method of apportionment under § 69, similar to that approved in *Jones & Laughlin*.[3] Trinova's requested 1980 tax base apportionment would have resulted in a *negative* adjusted tax base of $2,042,458, reducing its tax laibility for that year to zero.[4] Trinova's refund and apportionment relief request was denied.

Trinova then filed suit in the Court of Claims, seeking the apportionment relief previously requested, as well as $293,528 it claimed as an overpayment for 1980.[5] On

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[3] In the Court of Claims, Judge Bell recognized this deficiency in Trinova's claim for § 69 relief. He concluded, however, that because such a defect was noted in the *Jones & Laughlin* case, but was not found to foreclose § 69 relief, similar treatment of Trinova was justified.

[4] Trinova's requested apportionment calculations provided:

Tax base		221,125,319
Deduct: Compensation	226,356,271	
Depreciation	23,262,909	249,619,180
Total		(28,493,861)
Apportionment 8.9717%		(2,556,384)
Add: Michigan compensation		511,774
Michigan depreciation		2,152
Allocated and apportioned tax base		(2,042,458)

[5] The state filed a counterclaim in the Court of Claims, alleging that the single business tax formula failed to fairly represent "the extent of Plaintiff's use of the State of Michigan as a market for its products," and "the significant amount of receipts which plaintiff derives from its business activities in Michigan." The state offered an alternative one-factor formula based entirely upon Trinova's Michigan sales. The state argued that Trinova's actual sales amounted to $103,981,354, but that its estimated sales under the act were only $35,196,000. Thus, the state offered that its one-factor formula was substantially more accurate than that envisioned under the act or the formula offered by Trinova.

The court rejected the state's claim as a greater distortion of Trinova's Michigan business activity than that which resulted under the act's formula. The court acknowledged that Trinova's formula

cross motions for summary disposition, the Honorable Robert Holmes Bell agreed with Trinova that the statutorily provided apportionment formula did not fairly represent its 1980 business activity and ordered the state to accept Trinova's amended tax return for the year 1980. Relying on the reasoning of the Court of Appeals in *Jones & Laughlin*, Judge Bell further ordered the refund of any overpayment and interest due on the basis of Trinova's alternative apportionment formula.

The Court of Appeals reversed the decision of the Court of Claims, specifically rejecting the analysis of the *Jones & Laughlin* court. The Court concluded that relief under § 69 "was available only where application of the apportionment formula resulted in an unfair representation of the taxpayer's Michigan-based business activity taken as a whole." *Trinova v Dep't of Treasury*, 166 Mich App 656, 663; 421 NW2d 258 (1988). The Court further concluded that 1987 PA 39 was intended to apply retroactively, *id.*, p 665, but did not reach the issue as to whether retroactive application of 1987 PA 39 was constitutional. Rather, the case was remanded to the Court of Claims for further factual development and reconsideration in light of 1987 PA 39.

Trinova appealed that ruling to this Court, and we granted leave to appeal. 430 Mich 876 (1988).

II

INTRODUCTION

Our resolution of this dispute does not require that we scrutinize the mechanics of the Single Business Tax Act in detail. However, to appreciate the issues raised on appeal, a basic understanding of the components and workings of the single business tax will be helpful. The

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was not perfect, but found it to be superior to that provided under the act or offered by the state. It appears that the state did not pursue its counterclaim on appeal.

single business tax is a form of value added tax, although it is not a pure value added tax. *Town & Country Dodge, Inc v Dep't of Treasury*, 420 Mich 226, 234; 362 NW2d 618 (1984).[6] "Value added is defined as the increase in the value of goods and services brought about by whatever a business does to them between the time of purchase and the time of sale."[7] In short, a value added tax is a tax upon business activity. The act employs a value added measure of business activity, but its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan. It is not a tax upon income. MCL 208.31(4); MSA 7.558(31)(4).

Value added, or business activity, is subject to calculation by two equivalent methods. The first method begins with the taxpayer's gross receipts from which all outside purchases are subtracted. The residual figure represents the value added by the internal operations of the taxpayer. The second method is additive. All internal payments representing factors of production such as wages, rent, interest, together with the taxpayer's profit are totaled and constitute the value added by the taxpayer's efforts.[8] The act employs a modified additive method of value added computation. *Mobil Oil Corp v Dep't of Treasury*, 422 Mich 473, 495-497; 373 NW2d 730 (1985).

The computation of the tax involves several steps beginning with the calculation of the taxpayer's tax base.[9]

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[6] The single business tax is considered not to be a pure value added tax because of various exclusions, exemptions, and industry-specific adjustments that were adopted by the Legislature when the tax was enacted. See Haughey, *The economic logic of the single business tax*, 22 Wayne L R 1017, 1026-1027 (1976).

[7] Haughey, n 6 *supra*, p 1018.

[8] See Haughey, n 6 *supra*, pp 1018-1019; Special Report, *Evaluation of an additive-method value-added tax for use in the United States*, 30 Tax Lawyer 565, 566 (1977).

[9] See Kasischke, *Computation of the Michigan single business tax: Theory and mechanics*, 22 Wayne L R 1069 (1976); United States Advisory Commission on Intergovernmental Relations, *The Michigan single business tax: A different approach to state business taxation* (1978).

Under the act, "tax base" is defined as business income (or loss) before apportionment subject to certain adjustments. MCL 208.9; MSA 7.558(9). "Business income" is essentially federal taxable income. MCL 208.3(3); MSA 7.558(3)(3). Common adjustments to business income include additions to reflect the business consumption of labor and capital. Those include adding back compensation, depreciation, dividends, and interest *paid* by the taxpayer to the extent deducted from federal taxable income. Common deductions from business income include dividends, interest, and royalties *received* by the taxpayer to the extent included in federal taxable income.[10] This income is deducted for the purpose of value added computation because it does not result from capital expenditure by the taxpayer. Kasischke, *Computation of the Michigan single business tax: Theory and mechanics*, 22 Wayne L R 1069, 1081 (1976).

Once the taxpayer's tax is determined, it must then be allocated to the state where the business activity of the taxpayer can be fairly attributed. "As a general principle, a State may not tax value earned outside its

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[10] In the instant case, Trinova's tax base for 1980 was $221,125,319 computed as follows:

1.	business income (loss)	$(42,466,114)
2.	add: compensation	226,356,271
	depreciation	23,262,909
	dividends, interest, royalties paid	22,908,950
	other	549,526
3.	subtotal	230,611,542
4.	deduct: dividends, interest, and royalties received	9,486,223
5.	Section 9 tax base	$221,125,319

borders." *ASARCO, Inc v Idaho State Tax Comm*, 458 US 307, 315; 102 S Ct 3103; 73 L Ed 2d 787 (1982). For example, if a business conducts its business activity exclusively in Michigan, its entire § 9 tax base would be allocated to Michigan and subject to taxation under the act. MCL 208.40; MSA 7.558(40). If, however, the taxpayer's business activity was only partially attributable to Michigan, only a portion of that activity may constitutionally be taxed. Consequently, the act provides a formula for apportioning a taxpayer's tax base between two or more taxing states. MCL 208.45; MSA 7.558(45). The apportionment formula is an average computed as follows:

1. $\frac{\text{value of taxpayer's Michigan property}}{\text{average value of taxpayer's total property}} = X$
2. $\frac{\text{total wages paid in Michigan}}{\text{total wages paid by the taxpayer}} = Y$ [11]
3. $\frac{\text{sales within Michigan}}{\text{total sales}} = Z$
4. $\frac{X+Y+Z}{3} =$ § 45 apportionment percentage [12]
5. Section 9 tax base × § 45 apportionment % = taxpayer's apportioned tax base subject to tax.

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[11] Wages differ from compensation under the act. In MCL 208.49; MSA 7.558(49), the definition of "wages" is taken from § 3401 of the Internal Revenue Code and includes, with certain exceptions, any "remuneration . . . for services performed by an employee for his employer . . . ." 26 USC 3401(a). Recall that "compensation" is made up of wages together with payments for such things as unemployment compensation, FICA taxes, workers' compensation, etc. Thus, "wages" is not synonymous with "compensation."

[12] This formula is patterned after § 18 of the Uniform Division of Income for Tax Purposes Act. 7A ULA 355. See also anno: *Construction and application of uniform division of income for tax purposes act*, 8 ALR4th 934; Pierce, *The uniform division of income for state tax purposes*, 35 Taxes 747 (1957).

In this case, the value of Trinova's apportioned property equaled .0930 (X = .0930), its apportioned compensation equaled .2328 (Y = .2328), and its apportioned sales equaled 26.5892 (Z = 26.5892). Thus, $\frac{X+Y+Z}{3} = 8.9717$. Trinova's adjusted tax base is therefore its tax base (221,125,319) multiplied by the apportionment percentage (8.9717), equaling $19,838,700.

Once apportioned, the tax base is then subject to certain adjustments which are not significant for the purpose of this description. The taxpayer, under limited circumstances, also may elect to reduce its apportioned tax base as provided under § 31 to compensate for high labor compensation costs [13] or if its tax base is large in relation to its gross receipts. MCL 208.31(2), (5); MSA 7.558(31)(2), (5).[14] Once apportioned and adjusted, the tax base is then multiplied by 2.35 percent to determine the taxpayer's tax liability. MCL 208.31(1); MSA 7.558(31)(1).

At the heart of this dispute is an additional provision applicable when the taxpayer demonstrates that the apportionment formula provided in § 45 does not fairly represent the extent of its business activity in the state. MCL 208.69; MSA 7.558(69), prior to 1987 PA 39, provided:

> (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's

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[13] For example, under MCL 208.31(5); MSA 7.558(31)(5), Trinova was permitted to reduce its adjusted tax base by the percentage that its compensation divided by its unadjusted tax base exceeded sixty-three percent, such reduction not to exceed thirty-seven percent. Trinova's compensation ($226,356,271) divided by its tax base ($221,125,319) equaled 102 percent. Thus, Trinova was entitled to further reduce its adjusted tax base ($19,829,637) by thirty-seven percent or $7,336,966, resulting in a final adjusted tax base subject to tax of $12,492,671.

Pursuant to 1987 PA 39, the definition of "adjusted tax base" now includes the adjustments provided in § 31. Thus, Trinova's "adjusted tax base" is $12,492,671 rather than $19,829,637.

[14] See Kasischke, *supra*, pp 1091-1093.

business activity in this state, the taxpayer may petition for or the commissioner may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting.

(b) The exclusion of any 1 or more of the factors.

(c) The inclusion of 1 or more additional factors which will fairly represent the taxpayer's business activity in this state.

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

(2) An alternate method will be effective only if it is approved by the commissioner.

At issue in this case is whether the Court of Appeals properly rejected Trinova's request for § 69 relief.

III

STATUTORY ANALYSIS

We are first asked to consider the propriety of the Court of Appeals ruling in *Jones & Laughlin Steel Corp, supra*, which was relied upon by the Court of Claims and rejected by the Court of Appeals in the instant case.[15] In that case, Jones & Laughlin challenged its tax base apportionment as derived under the statutory three-factor formula for the tax years 1976, 1977, and 1978. For those years the three-factor formula resulted in the apportionment of compensation expense to Michigan which exceeded the taxpayer's actual compensation expense by

[15] The *Jones & Laughlin* case was a consolidation of a similar dispute involving Wilson Foods Corporation. For the purpose of this discussion we refer only to the claims of Jones & Laughlin.

an average of sixty- two percent.[16] Further, the compensation component comprised between eighty-five and ninety-four percent of Jones & Laughlin's adjusted tax base. On the basis of this information, Jones & Laughlin successfully argued that the statutory apportionment formula failed to fairly reflect its Michigan business activity and also gained approval of an alternate apportionment formula which is similar to that used by Trinova in the case at bar.

The apportionment method approved by the *Jones & Laughlin* Court applied the statutory three-factor formula to the taxpayer's § 9 tax base exclusive of the adjustment for compensation. To this figure the taxpayer's actual Michigan compensation was allocated. The sum of these two figures was then multiplied by the statutory rate to determine the single business tax liability. The Court found this method preferable because it employed the taxpayer's actual compensation figure rather than an approximated amount which "excessively attributed compensation to Michigan." *Jones & Laughlin, supra*, p 413. The Court specifically rejected the state's claim that § 69 relief was warranted only if the apportionment formula resulted in an unfair tax liability. Rather, the Court ruled that when any element of the taxpayer's business activity as reflected in its tax base is shown to be inaccurately represented, § 69 relief is available.

We reject the *Jones & Laughlin* rule because it effectively negates those sections of the act specifying the method for calculating apportioned tax base and thereby converts § 69 into an all-purpose tax equity provision. We believe that the error of the *Jones & Laughlin* Court may be traced to an incorrect understanding of the concept of fair apportionment.

[16] Jones & Laughlin's compensation figures for the disputed tax years provided:

Year	Michigan Comp	Apportioned Comp	% over Actual
1976	26,385,639	39,902,544	51.2
1977	21,629,704	38,662,908	78.7
1978	21,782,621	33,739,117	54.9

A

The Legislature has determined that § 69 apportionment relief may be obtained "[i]f the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state . . . ." Our first task is to determine what is meant by "fairly represent" as it relates to the proper operation of the statutory apportionment formula. Obviously, from the taxpayer's perspective, fair business activity representation is that which results in the lowest possible apportioned tax base and resulting tax liability. From the viewpoint of the state, fair representation translates into accountability for every activity of the taxpayer which under the law may be taxed by this state. While the result might be the same under either approach, in practice they are not compatible viewpoints. Consequently, unless the concept of fairness is rooted in something other than the conflicting values of the state and taxpayer or vague notions of equity, it is useless as a demarcation of entitlement to relief.

We therefore begin with the unchallenged premise that a fair representation of business activity in this case must be directed to the purpose of apportionment. The central purpose of any apportionment scheme is to "ensure that each State taxes only its fair share of an interstate transaction." *Goldberg v Sweet*, 488 US ——: 109 S Ct 582, 588; 102 L Ed 2d 607 (1989). Thus, a fair representation of business activity is one which ensures that each state taxes only its share of interstate transactions. With that central function in mind, it becomes obvious that § 69 functions essentially as a constitutional "circuit breaker."

Taxation of the intrastate activity of an interstate enterprise presents the potential for Due Process and Commerce Clause violations.[17] To preserve the constitution-

[17] A state tax when applied to interstate commerce will be sustained under Commerce Clause analysis "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc v Brady*, 430 US 274, 279; 97 S Ct 1076; 51 L Ed 2d 326 (1977). See also *Amerada Hess Corp v New Jersey Dep't of the Treasury*, 490 US ——; 109 S Ct 1617; 104 L Ed 2d 58 (1989).

For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: "a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp v Comm'r of Taxes of Vermont*, 445 US 425, 436-437; 100 S Ct 1223; 63 L Ed 2d 510 (1980).

[18] A "unitary business" has been defined "as a single business conducted both within and without the taxing state and whose tax base cannot be satisfactorily identified on a geographical basis." Hellerstein, *State income taxation of multijurisdictional corporations: Reflections on Mobil, Exxon, and H. R. 5076*, 79 Mich L R 113, 122, n 50 (1980). Appellant does not contest the fact that it is a "unitary business" for the purpose of apportionment and taxation under the act.

ality of the act, § 69 allows the use of an alternate method of apportionment if the apportionment provisions result in the unconstitutional taxation of a unitary business.[18] In other words, we believe that § 69 applies only in the most unusual of circumstances—when the statutory method operates unconstitutionally to tax the extraterritorial activity of the taxpayer. While admittedly the taxpayer gains from the operation of § 69 by a reduction of its apportioned tax base, the primary role of § 69 is to safeguard the act and not to shelter the taxpayer. Only when read in light of this basic constitutional foundation does "fairness" as a guiding principle serve the function of objective measure. Consequently, we turn to established constitutional doctrine to ascertain the guideposts of "fairness" in our review of the act's formulary apportionment scheme.

B

As a general rule, a state may not "tax value earned outside its borders." *ASARCO, Inc, supra, p 315. "In the case of a more-or-less integrated business enterprise operating in more than one state, however, arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice." Container Corp v Franchise Tax Bd*, 463 US 159, 164; 103 S Ct 2933; 77 L Ed 2d 545 (1983). Because of the nebulous nature of value or, in this case, business activity, and the difficulty confronted when attempting to identify purely intrastate value, the United States Supreme Court has refused to require the use of one formula to the exclusion of all others. *Id.; Goldberg v Sweet, supra*, 109 S Ct 588. "Such an apportionment formula must, under both the Due Process and Commerce Clauses, be fair." *Container Corp, supra*, p 169. See also *Shell Oil Co v. Iowa Dep't of Revenue*, 488 US ——; 109 S Ct 278; 102 L Ed 2d 186, 199 (1988) (the function of an apportionment formula is to determine the portion of a unitary business' income that can be "fairly" attributed to in-state activities).

The first component of fairness in an apportionment formula has been termed "internal consistency." *Id.*[19] To be internally consistent, a formula must result in no more than one-hundred percent of the taxpayer's business activity being taxed if all taxing jurisdictions employed the same formula. In this case, the apportionment provisions of the single business tax are internally consistent because no multiple taxation would result if every state were to adopt the act. The business activity of any unitary business would be apportioned by each taxing jurisdiction using the identical method. Trinova does not con-

[19] See, generally, Hellerstein, *Is "internal consistency" foolish: Reflections on an emerging Commerce Clause restraint on state taxation*, 87 Mich L R 138 (1988).

test the internal consistency of the act's apportionment formula.

The second component of a fair apportionment formula is "external consistency." External consistency requires that the choice of factors used in the formula "must actually reflect a reasonable sense of how [the business activity] is generated." *Id.; Goldberg v Sweet, supra*, 109 S Ct 589. The constitution does not require an exact apportionment, and an apportionment formula will not be judged to be unfair if "it *may* result in taxation of some [business activity] that did not have its source in the taxing State . . . ." *Moorman Mfg Co v Bair*, 437 US 267, 272; 98 S Ct 2340; 57 L Ed 2d 197 (1978). An apportionment formula will be struck as being externally inconsistent only upon a showing by the taxpayer of "clear and cogent evidence" that the business activity attributed to the state is "out of all appropriate proportions" to the business transacted in that state, or "has led to a grossly distorted result." *Moorman Mfg Co, supra*, p 274; *Norfolk & Western R Co v Missouri State Tax Comm*, 390 US 317, 326; 88 S Ct 995; 19 L Ed 2d 1201 (1968).[20]

In *Jones & Laughlin*, the Court of Appeals ignored these principles of fair apportionment. Rather, it found the statutory apportionment formula to unfairly represent the extent of the taxpayer's intrastate business ac-

[20] Although our opinion is not based upon this observation, we find it instructive that the amended § 69 now provides in relevant part:

> The apportionment provisions of this act shall fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of the tax base such as depreciation, compensation, or income, unless it can be demonstrated that the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business transacted in this state and leads to a grossly distorted result. [MCL 208.69(3); MSA 7.558(69)(3), as amended by 1987 PA 39.]

tivity because compensation, as reflected in the § 9 tax base, was "over-apportioned or excessively attributed" to Michigan. *Jones & Laughlin, supra*, p 413. We cannot agree with this conclusion.[21]

First, while we agree with the *Jones & Laughlin* Court that the test for fairness is not whether the taxpayer's final tax liability is reasonable when weighed against its intrastate business activity, we disagree with the standard adopted by that Court. The Court of Appeals determined that the statutory formula yielded an unfair apportionment because 1) eighty-five to one hundred percent of the taxpayers' adjusted tax bases consisted of compensation; 2) use of the three-factor formula overstated compensation more than fifty percent; and 3) the taxpayers' actual Michigan compensation could be precisely calculated. On these facts, the Court held that the taxpayers had "presented clear and convincing evidence 'that the statutory formula inadequately or inaccurately represent[ed] [their] unitary business activity in the taxing state.'" *Jones & Laughlin, supra*, p 413, quoting, *Dono-*

[21] Arguably, the taxpayer's true dispute in *Jones & Laughlin* was not with the apportionment formula, but, rather, with the computation of the § 9 tax base. Indeed, the taxpayers alternate formula in that case simply applied the statutory formula to its § 9 tax base exclusive of the compensation adjustment and allocated the exact amount of its Michigan compensation to the apportioned figure.

Indeed, in its reply brief, Trinova admits that it questions the constitutionality of the § 9 tax base computation and claims that § 69 after *Jones & Laughlin* "cure[d] the flaws in the method by which Section 9 establishes the tax base." Trinova is mistaken as to the proper function of § 69. Its purpose is to provide relief when the statutory apportionment provisions result in the unconstitutional taxation of a unitary business. Section 69 was not intended to shelter the taxpayer from rightful tax liability and should not be read to provide apportionment relief anytime a taxpayer can show, by manipulating its tax base, that a lower tax liability can be achieved. When read in this manner, § 69, which was intended by the Legislature to be the rule of exception, becomes instead the rule of general application.

van v Dep't of Treasury, 126 Mich App 11, 21; 337 NW2d 297 (1983). As noted, however, the test for fair apportionment is not whether a formula results in inadequate or even inaccurate apportionment. The test is whether the use of a particular method of apportionment results in business activity being attributed to this state which is "out of all appropriate proportions" to the taxpayer's intrastate business activity, or has "led to a grossly distorted result."[22]

As explained earlier, "fairness" in the context of multistate tax or tax base apportionment must be considered under Due Process and Commerce Clause analysis. The opinion of the Court of Appeals in *Jones & Laughlin* is wholly lacking in consideration of internal consistency. Even assuming that the Court's analysis was directed towards the concerns of external consistency, we do not believe that identifying a fifty-percent overstatement of compensation, which is but one element of the taxpayer's intrastate business activity, demonstrates by "clear and cogent evidence" that the business activity attributed to this state was "out of all appropriate proportion" to the business transacted in the state, or has led "to a grossly distorted result."

As a precondition to § 69 relief, a showing must be made that the taxpayer's business activity within this state is unfairly represented. Under the Single Business Tax Act, "business activity" is defined as encompassing any transfer of property, performance of services, or a combination thereof "with the object of gain, benefit, or

[22] We recognize that a juxtaposition of this language with that of § 69 suggests a teleological gulf. However, had the legislation utilized this precise language, the statute would be left inflexibly tied to the language of the most recent position of the United States Supreme Court without regard to subsequent changes. Flexibility, which we believe to be the essential purpose of § 69, requires the more general language of "fairly represent." Unfortunately, it appears that *Jones & Laughlin* has forced the Legislature's hand in amending the code. See n 20, p 158.

advantage." MCL 208.3(2); MSA 7.588(3)(2).[23] The subject of the act thus encompasses the complete range of entrepreneurial activities of which compensating employees is but one part. Consequently, to conclude that a taxpayer's business activity is not fairly apportioned because a single component of that activity, when examined by geographical accounting, is not accurately reflected under the statutory apportionment scheme belies the very definition of business activity. "The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corp, supra*, pp 164-165.

Obviously, compensation will be a substantial portion of the tax base in most businesses. Nonetheless, we cannot ignore the integrated nature of formulary apportionment which rejects separate accounting as a means to identify business activity by reference to a discrete geographic boundary. As the United States Supreme Court has observed, it is "precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." *Con-*

[23] MCL 208.3(2); MSA 7.558(3)(2) provides:

> "Business activity" means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services rendered by an employee to his employer, services as a director of a corporation, or a casual transaction. Although an activity of a taxpayer may be incidental to another or other of his business activities, each activity shall be considered to be business engaged in within the meaning of this act.

tainer Corp, supra, p 181.[24] Further, while admittedly the three- factor formula is not perfect, and its application in a value added tax scheme is relatively unique, the constitution requires neither a perfect formula nor a perfect apportionment. The United States Supreme Court long ago upheld the constitutionality of formulary apportionment. See, e.g., *Hans Rees' Sons, Inc v North Carolina*, 283 US 123; 51 S Ct 385; 75 L Ed 879 (1931). Further, the Court has specifically found that property, payroll, and sales may be appropriate ingredients of an apportionment formula, *Butler Bros v McColgan*, 315 US 501, 509; 62 S Ct 701; 86 L Ed 991 (1942). Indeed, the three-factor formula is viewed as "something of a benchmark against which other apportionment formulas are judged." *Container Corp, supra*, p 170. See also *Amerada Hess Corp v New Jersey Dep't of the Treasury*, 490 US ——; 109 S Ct 1617; 104 L Ed 2d 58 (1989).

In short, while we recognize that certain components of the taxpayer's business activity are subject to accurate geographic attribution, we do not believe that "business activity" as defined under the act is susceptible to accurate analysis when only one component of the total business effort is examined. To properly judge the propriety of a taxpayer's apportioned business activity, we must view the activity as a whole.

[24] In *Mobil Oil Corp v Comm'r of Taxes of Vermont*, n 17 *supra*, p 438, the United States Supreme Court aptly noted the failings of separate accounting:

> [S]eparate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required. [Citations omitted.]

IV

THE APPLICATION OF § 69 TO TRINOVA

In the present case, Trinova sought § 69 apportionment relief on the ground that its apportioned 1980 compensation was approximately forty times greater than its actual Michigan compensation, and that its apportioned depreciation was approximately one thousand times greater than its actual Michigan depreciation. On the basis of these two facts, Trinova persuaded the Court of Claims that the *Jones & Laughlin* rule entitled it to relief because the act's apportionment formula failed to accurately represent its Michigan business activity. We do not believe that these two facts show by "clear and cogent evidence" that the statutory apportionment provisions attributed business activity to Michigan which was "out of all appropriate proportion" to Trinova's actual business transacted in Michigan, or "has led to a grossly distorted result."

As calculated under § 45, the apportionment formula resulted in an apportionment percentage of 8.9717. More specifically, of Trinova's § 9 tax base of $221,125,319, approximately nine percent was apportioned to Michigan resulting in an apportioned tax base of $19,838,700. We simply cannot conclude as a matter of law that this amount is out of all appropriate proportion to Trinova's Michigan business activity or results in a grossly distorted apportionment figure. Trinova's actual Michigan compensation was $511,774, and its actual property as reflected in its depreciation expense was $2,152. While these figures obviously represent a very small percentage of Trinova's total business activity, they are offset by its Michigan sales figure of $103,981,354.[25] When viewed as

[25] Sales of goods are considered in this state if "[t]he property is shipped or delivered to a purchaser, other than the United States government, within this state regardless of the free on board point or other conditions of the sale." MCL 208.52(a); MSA 7.558(52)(a). Under MCL 208.3; MSA 7.558(3), "business activity" includes the transfer of legal title to property in this state with the object of gain, benefit, or advantage. Thus, under the act, Trinova's sales to Michigan purchasers clearly were "business activity."

a whole, we believe the averaged ratios of Trinova's payroll, property, and sales "actually reflect a reasonable sense of how [its Michigan business activity was] generated," clearly satisfying the constitutional requirements of internal and external consistency.

We emphasize that § 69 was not intended as an all-purpose tax equity provision. However, assuming arguendo that the Legislature intended § 69 as a tax equity provision, we would nevertheless reject Trinova's petition [26] for relief. Our reading of MCL 208.68(1); MSA

[26] Although the matter is not addressed by the parties to this appeal, we believe that the *Jones & Laughlin* Court also erred procedurally. In *Jones & Laughlin*, the Tax Tribunal's grant of relief was affirmed despite the taxpayer's failure to "petition" the commissioner for relief as required by § 69(1) or obtain approval for the alternate formula as required by § 69(2). In our view, § 69(1) clearly requires that a taxpayer petition for relief before an alternate apportionment formula will be considered. Further, § 69(2) specifically mandates that "[a]n alternate method will be effective only if it is approved by the commissioner." MCL 208.69(2); MSA 7.558(69)(2). It is undisputed that the taxpayers in *Jones & Laughlin* neither petitioned for, nor obtained commissioner approval of the apportionment formula ultimately used. The Tax Tribunal excused this requirement in *Jones & Laughlin* because of a lack of procedural rules for the evaluation of an alternate formula. We cannot so easily disregard the express language of §§ 69(1) and 69(2).

The petition requirement of § 69(1) and the prior approval requirement of § 69(2) are in no way dependent upon the adoption of formal procedural rules for the evaluation of an alternate apportionment formula. We cannot condone a ruling which permits clear legislation to be ignored. In short, the Court of Appeals in *Jones & Laughlin* failed to properly determine the fairness of the statutory apportionment formula under accepted constitutional measures and further failed to enforce the express procedural

7.558(68)(1) indicates that certain businesses which do not own or rent real estate or tangible personal property in Michigan and which do not have gross sales in Michigan in excess of $100,000 may use an apportioned tax base consisting only of sales. Thus, it is clear that the Legislature was aware that business activity heavily weighted toward sales might better be taxed upon a different base. However, the Legislature provided relief in only the more extreme cases. The apportionment formula proposed by Trinova under § 69 [27] uses a tax base identical to that provided in § 68, yet Trinova does not meet any of the qualifying criteria imposed by the Legislature. We find it most difficult to believe that the Legislature intended to provide relief under the general provision of § 69 which it expressly precluded under the more specific § 68. See, generally, 2A Sands, Sutherland Statutory Construction (4th ed), § 51.05, pp 499-500. It is indeed the careful and specific drafting of the Single Business Tax Act which leads us to the conclusion that the Legislature saw no need for an all-purpose tax equity provision.

In passing, we also note that the sales at issue were not "at retail," MCL 205.51; MSA 7.521, and therefore do not fall within Michigan's General Sales Tax Act, MCL 205.52; MSA 7.522. Therefore, if Trinova's construction of the Single Business Tax Act is correct, $103,981,354 in sales will be entirely untaxed. Considering the two acts in pari materia, *County Rd Ass'n of Michigan v Bd of State Canvassers*, 407 Mich 101, 118-119; 282 NW2d 774 (1979),[28] we believe that this result

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requirement of §§ 69(1) and 69(2) before approving the taxpayers' requests for apportionment relief. This is clarified in the amended § 69(4). In remanding this matter, we do not preclude the defendant from raising this issue in the Court of Claims.

[27] See n 4.

[28] As explained in 2A Sands, Sutherland Statutory Construction (4th ed), § 51.03, p 468, the guiding principle for whether statutes

was not within the intentions of the Legislature in enacting the single business tax. Again, we observe the express legislative intent that the "tax so levied and imposed is upon the privilege of doing business . . . ." MCL 208.31(4); MSA 7.558(31)(4).

While we do not adopt all of the reasoning of the Court of Appeals in this case, we agree with its conclusion that Trinova has failed to demonstrate an entitlement to tax-base relief under § 69. To the extent that the decision in *Jones & Laughlin* is inconsistent with this opinion, it is overruled. [29]

CONCLUSION

We hold that § 69 apportionment relief may obtain upon a showing by the challenging party of clear and cogent evidence that the total business activity attributed to the state is out of all appropriate proportion to the taxpayer's intrastate business activity or has led to a grossly distorted result. Here, the challenging party, Trinova, has failed to show that its total business activity attributed to Michigan is out of all appropriate proportion to the taxpayers intrastate business or has led to a grossly distorted result.

We therefore affirm that aspect of the Court of Appeals decision reversing the decision of the Court of

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are in pari materia is whether it is natural and reasonable to think that the understanding of members of the Legislature would be influenced by the other statute. In our view, it is natural and reasonable to think that the Legislature considered the scope of the General Sales Tax Act in drafting the Single Business Tax Act.

[29] We also are asked to decide whether 1987 PA 39 was intended by the Legislature to apply retroactively to tax years prior to 1987, and, if so, whether that enactment is constitutional. The Attorney General argues that even if *Jones & Laughlin* correctly construed the act prior to amendment, 1987 PA 39 must be applied retroactively to defeat Trinova's claim. Trinova itself seeks no relief under the amendment. Therefore, in light of our rejection of the rule of *Jones & Laughlin* and Trinova's claim for apportionment relief, we find it unnecessary to reach these remaining two issues.

Claims. This matter is remanded to the Court of Claims for further proceedings consistent with this opinion.

RILEY, C.J., and BRICKLEY, CAVANAGH, ARCHER, and GRIFFIN, JJ., concurred with BOYLE, J.

LEVIN, J. (*separate opinion*). I would remand this cause for a hearing, together with the several hundred other cases pending in the Court of Claims, on the factual issues adverted to in the briefs of the parties and the amici curiae and in the opinion of the Court. See *Commonwealth Edison Co v Montana*, 453 US 609, 638; 101 S Ct 2946; 69 L Ed 2d 884 (1981) (Blackmun, J., dissenting).

Michigan Supreme Court
Lansing, Michigan

Order

Entered: October 16, 1989

Rehearing No. 223

SC 82673
CoA 100641
LC 86-10430-CM

TRINOVA CORPORATION (formerly
LIBBEY-OWENS-FORD COMPANY),
Plaintiff-Appellant,

v

STATE OF MICHIGAN, DEPARTMENT OF TREASURY,
REVENUE DIVISION,
Defendant-Appellee.

In this cause, a motion for rehearing, is considered and, on order of the Court, it is hereby DENIED.

I, CORBIN R. DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of Court.

[SEAL]

October 16, 1989

s/ Jacqueline B. MacKinnon
Deputy Clerk

MICHIGAN COURT OF APPEALS

Docket No. 100641

TRINOVA CORPORATION

v.

DEPARTMENT OF TREASURY

Submitted February 11, 1988, at Lansing
Decided February 22, 1988
Leave to appeal granted, 430 Mich —.

Trinova Corporation, an Ohio corporation licensed to do business in Michigan, brought an action against the Michigan Department of Treasury in the Court of Claims, seeking to recover $293,528 which it allegedly overpaid on its single business tax in 1980. Trinova claimed that the statutorily mandated three-factor average percentage used to determine the corporation's Michigan business activity when applied to the compensation and property factors resulted in compensation and property figures which were well in excess of the actual figures and that, on the basis of the holding in *Jones & Laughlin Steel Corp v Dep't of Treasury*, 145 Mich App 405 (1985), it was entitled to an alternative method of apportionment which would result in the claimed tax saving. The Department of Treasury argued that Trinova was not entitled to use an alternative metnod of apportionment and that Trinova owed additional taxes for 1980 on the basis of an alternative one-factor formula the department proposed. Both Trinova and the department moved for summary disposition. The Court of Claims, Robert Holmes Bell, J., granted Trinova's motion for summary disposition, adopted the reasoning of *Jones & Laughlin* and held that, as a matter of law, the statutory apportionment formula failed to accurately reflect Trinova's Michigan business activity. The department appealed.

The Court of Appeals *held:*

1. The holding in *Jones & Laughlin* is rejected, since the *Jones & Laughlin* opinion fails to take into account that, to the extent that the statutorily computed average figure would overevaluate one or two of the three factors making up the average, it would have the effect of underevaluating the remaining factor or factors. The Legislature's 1987 legislative response to the *Jones & Laughlin* decision clearly evidences that it was always the intent of the Legislature that the alternative method of apportionment provision was to be available only where application of the apportionment figure calculated from the statutory formula would result in an unfair representation of the taxpayer's Michigan business activity taken as a whole.

2. Since the 1987 amendment by the Legislature was to clarify its original intent in the face of a judicial pronouncement which was contrary to the Legislature's original intent, it is proper to give retrospective application to the provisions of the 1987 amendment.

Reversed and remanded.

1. TAXATION—SINGLE BUSINESS TAX—APPORTIONMENT OF TAX BASE—ALTERNATIVE METHODS OF APPORTIONMENT.

Relief from application of the three-factor apportionment formula of the Single Business Tax Act was available under the provision allowing exemption from the

allocation provision under certain circumstances prior to the 1987 amendment of that provision only where application of the apportionment formula resulted in an unfair representation of the taxpayer's Michigan business activity taken as a whole; relief under that section was not available merely because the calculated average failed to accurately reflect one or two of the three factors where final allocation resulting from the statutorily calculated figure fairly represented the Michigan business activity taken as a whole (MCL 208.69; MSA 7.558[69]).

2. TAXATION—SINGLE BUSINESS TAX—APPORTIONMENT OF TAX BASE—AMENDMENT OF STATUTES—LEGISLATIVE INTENT—RETROACTIVITY.

The Legislature clearly intended the 1987 amendment of the provision of the Single Business Tax Act permitting alternative methods of apportionment of tax base under certain circumstances to have retroactive effect; since it is clear that the 1987 amendment was a response to a decision of the Court of Appeals and evidenced a clear expression by the Legislature that the amendment was an attempt to more certainly express the Legislature's original intent, the amendatory section should be retrospectively applied to the date of the original statute (1987 PA 39; MCL 208.69; MSA 7.558[69]).

Dickinson, Wright, Moon, Van Dusen & Freeman (by *Ernest Getz and Elizabeth Trickey*), for plaintiff.

Frank J. Kelley, Attorney General, *Louis J. Caruso*, Solicitor General, and *Richard R. Roesch* and *Charles E. Liken*, Assistant Attorneys General, for defendant.

Amicus Curiae:

Clark, Klein & Beaumont (by *David H. Vincent, J. Walker Henry, Curtis J. Mann* and *Joseph A. Bonventre*), and *Thomas J. Hughes* and *E. Alan Moorhouse*, of Counsel, for Michigan Manufacturers Association.

Before: R.M. MAHER, P.J., and SHEPHERD and K. TERTZAG,* JJ.

PER CURIAM. The appeal involves the method by which plaintiff, Trinova Corporation, is to apportion its adjusted tax base to reflect its Michigan business activity for the year 1980 pursuant to the Single Business Tax Act, MCL 208.1 *et seq.*; MSA 7.558(1) *et seq.* Trinova, an Ohio corporation licensed to do business in Michigan, manufactures automobile parts which it sells throughout the United States, including Michigan. In 1980, Trinova had an office here and employed fourteen persons who solicited orders for Trinova's glass division and provided liaison with its Michigan customers. Trinova's 1980 sales in the state totaled $103,981,354, more than one-fourth of its total sales.

The Single Business Tax Act (SBTA) imposes a specific tax on what is known as the "adjusted tax base" of every person, such as Trinova, with business activity in Michigan which is allocated or apportioned to Michigan. *Town & Country Dodge, Inc v Dep't of Treasury*, 420 Mich 226, 234-235; 362 NW2d 618 (1984), reh den 421 Mich 1202 (1985); MCL 208.31(1); MSA 7.558(31)(1). As was held by this Court in *Wismer & Becker Contracting Engineers v Dep't of Treasury*, 146 Mich App 690, 696; 382 NW2d 505 (1985):

> The Single Business Tax is a tax upon the privilege of doing business and not upon income. It "is best understood as a value added tax, although it is not a pure value added tax." *Town & Country Dodge, Inc v Dep't of Treasury*, 420 Mich 226, 234; 362 NW2d 618 (1984). A value added tax taxes economic activity itself, unlike an income tax, which taxes what has been received from the economy at a later time when it become "income." *Mobile Oil Corp v Dep't of Treasury*, 422 Mich 473; 373 NW2d

* Circuit judge, sitting on the Court of Appeals by assignment.

730 (1985). In theory, the income tax and the value added tax impose a tax on the same things, but at different stages of the economic process, and should generate the same amount of revenue, even though collected from different sources. See *Mobil Oil Corp, supra.*

The adjusted tax base to which the single business tax applies consists of federal taxable income subject to certain additions and subtractions contained in § 9 of the act. MCL 208.9; MSA 7.558(9).

Since Trinova has taxable activities both within and outside Michigan, it is liable for an apportioned single business tax pursuant to MCL 208.41; MSA 7.558(41). The apportionment is arrived at by applying a three-factor formula to the adjusted tax base:

> All of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3. [MCL 208.45; MSA 7.558(45).][1]

The purpose of this formula is to determine that proportion of a taxpayer's business activity which is attributable to its Michigan-based operations. In the instant case, the property factor was .0930 percent, the payroll factor was .2328 percent, and the sales factor was 26.5892 per-

[1] The apportionment formula is calculated by averaging the percentages of Trinova's property, payroll and sales attributable to its Michigan operation. Algebraically, that formula is:

$$\frac{\frac{\text{MICHIGAN PROPERTY}}{\text{TOTAL PROPERTY}} + \frac{\text{MICHIGAN PAYROLL}}{\text{TOTAL PAYROLL}} + \frac{\text{MICHIGAN SALES}}{\text{TOTAL SALES}}}{3}$$

cent. The average of those factors was 8.9717 percent.[2] This was the percentage which was applied to Trinova's adjusted tax base in order to arrive at its Michigan tax base.

In 1986, Trinova filed suit against the Department of Treasury in the Court of Claims, seeking to recover $293,528 in single business tax overpaid for the year 1980. It contended that the apportionment formula provisions of the SBTA did not fairly reflect Trivona's business activity in Michigan because, as applied, the formula resulted in an apportioned tax base in which taxed value was not rationally related to business conducted in Michigan. In support, Trinova asserted that its apportioned compensation under the formula was thirty-eight times greater than its actual compensation expenses attributable to Michigan and its apportioned depreciation (i.e., property) was 960 times greater than its actual Michigan depreciation expenses. Trinova sought relief pursuant to MCL 208.69; MSA 7.558(69) which, at the time the suit was filed, provided in relevant part:

> (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the commissioner may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> * * * *
>
> (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

[2] We must emphasize that the average factor of 8.9717 percent, is just that, an average. The effect of the higher sales percentage is offset by the smaller property and payroll factors, and vice versa. For a more in-depth explanation of the formula's rationale, see *Wismer & Becker Contracting Engineers, supra,* pp 698-702.

The department answered and counterclaimed, asserting that Trinova was not entitled to § 69 relief and, in fact, owed additional taxes for 1980 on the basis of an alternate one-factor formula it proposed. Each side filed a motion for summary disposition.

On May 5, 1987, the Court of Claims issued its opinion and order granting Trinova's motion for summary disposition and directing the department to refund to Trinova any overpayment and interest to which it was entitled.[3]

In claiming its refund, Trinova used a two-step apportionment/allocation method based on a method approved in *Jones & Laughlin Steel Corp v Dep't of Treasury*, 145 Mich App 405; 377 NW2d 397 (1985), lv den 424 Mich 895 (1986). In *Jones & Laughlin*, this Court approved a two-step method for the two taxpayers involved in that appeal by which each was permitted to apply the statutory three-factor apportionment formula to its adjusted tax base exclusive of the compensation adjustment of MCL 208.9(5); MSA 7.558(9)(5) and then use the actual amount of compensation attributable to Michigan. The Court found this alternate method to be appropriate because "petitioners presented clear and convincing evidence 'that the statutory formula inadequately or inaccurately represent(ed) (their) unitary business in [Michigan].'" 145 Mich App 413 (quoting *Donovan Construction Co v Dep't of Treasury*, 126 Mich App 11, 21, n2; 337 NW2d 297 [1983], lv den 419 Mich 894 [1984]). Thus, pursuant to that holding, and contrary to the dictates of § 9 of the SBTA, Trinova excluded compensation and depreciation from its preapportionment formula to this "adjusted tax base" and added Trinova's actual Michigan compensation and depreciation expenses to the apportionment product.

[3] The court also denied the department's motion for summary disposition and dismissed its counterclaim. The department has not cross-appealed those decisions.

In this case, the Court of Claims stated that it adopted the reasoning of *Jones & Laughlin* and held "as a matter of law based on the pleadings that the [SBTA's] apportionment formula failed to accurately represent [Trinova's] Michigan business activity." The Court of Claims here apparently applied the *Jones & Laughlin* rationale as a per se rule of law for, in interpreting the Court of Appeals decision, it stated:

> The Court of Appeals went on to hold that where even just one element of business activity is shown, by clear and convincing evidence, to be inaccurately represented by application of the apportionment formula, § 69 relief is available.

We take this opportunity to reject the logic of the *Jones & Laughlin* holding. Since the final apportionment percentage is the *average* of the component percentages (i.e., property, payroll and sales), it will always be larger than at least one of the component percentages unless, of course, they are all equal. Under *Jones & Laughlin*, a foreign taxpayer could defeat the tax simply by taking one factor, the percentage of which is smaller than the average, and applying the average to the total dollar value of that factor. This overvaluation is, as previously mentioned (see footnote 2), offset by the underevaluation of the factor or factors in the apportionment formula for which the actual amount of Michigan activity is larger than the amount calculated using the statutory average. The net effect of the apportionment formula is to ascertain that portion of the foreign taxpayer's adjusted tax base attributable to its business activity in this state. The right to § 69 relief was available only where application of the apportionment formula resulted in an unfair representation of the taxpayer's Michigan-based business activity taken as a whole.

The fallacy of Trinova's instant claim is that it focused only on those factors which distorted the average per-

centage in a manner supporting its claim of overevaluation and failed to recognize the offsetting factors inherent in the apportionment formula. Likewise, this was the error in *Jones & Laughlin*.

A little more than a month after the Court of Claims ruled in Trinova's favor, the Legislature, on June 8, 1987, passed 1987 PA 39 which amended § 69 of the SBTA and, by its terms, was ordered to take immediate effect. The amended version of § 69 uses two tests to determine whether the apportionment formula fairly represents a taxpayer's business activity in Michigan.

> The apportionment provisions of this act shall fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of the tax base such as depreciation, compensation, or income, unless it can be demonstrated that the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business transacted in this state and leads to a grossly distorted result. A taxpayer's business activity shall be presumed to be fairly represented if the adjusted tax base computed without regard to the reduction based upon gross receipts permitted by section 31(2) is not greater than the adjusted tax base computed after application of the reduction based upon gross receipts permitted by section 31(2) or if the adjusted tax base is not greater than the adjusted tax base which would result from an apportioned tax base computed by using the apportionment formula prescribed for a corporate income tax or franchise tax in the taxpayer's business domicile. The taxpayer's business domicile is the state in which the sum of the taxpayer's payroll factor and property factor is greatest. However, if the taxpayer fails to satisfy either of these tests, the taxpayer's business activity shall not be presumed to not be fairly represented. [MCL 208.69(3); MSA 7.558(69)(3).][4]

The department argues that § 69, as amended, is retroactive and that, given the requirements of the amendment, Trinova does not qualify for § 69 relief. Trinova, on the other hand, contends that § 69, as amended, should not be retroactively applied and that retroactive application would be unconstitutional. It also argues that, even under § 69 as amended, Trinova's entitlement to § 69 relief is not altered.

The Legislature enacted the amendment shortly after the Supreme Court denied leave to appeal in *Jones & Laughlin*, *supra*, and after it became apparent that the Court of Claims was applying its interpretation of the *Jones & Laughlin* rationale as a per se rule to other cases involving foreign corporation taxpayers. In amending § 69, the Legislature specifically declared its intention:

> This amendatory act is curative, expressing the original intent of the legislature that the single business tax imposed under the single business tax act, Act No. 228 of the Public Acts of 1975, being sections 208.1 to 208.145 of the Michigan Compiled Laws, is an indivisible value added type of tax and not a combination or series of several smaller taxes and that relief from formulary apportionment should be granted only under extraordinary circumstances. This amendatory act clarifies the existing procedures and standards for granting relief under section 69 of the single business tax act, Act No. 228 of the Public Acts of 1975, being section 208.69 of the Michigan Compiled Laws. [1987 PA 39, § 2.]

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[4] Two additional subsections were added to § 69 by 1987 PA 39. Subsection (4) provides that "the filing of a return or an amended return shall not be considered a petition for purposes of subsection (1)." Subsection (5) provides that "as used in this section, 'adjusted tax base' means that term as defined in section 31."

Clearly, the Legislature intended that 1987 PA 39 have retroactive effect. In *ACCO Industries, Inc v Dep't of Treasury*, 134 Mich App 316, 321-322; 350 NW2d 874 (1984), lv den 421 Mich 857 (1985), this Court declared that "a later statement of legislative intent by the Legislature is binding on this Court." Although the Legislature cannot, through amendment, change the settled meaning of a statute, it can amend a statute to make plain what the legislative intent had been all along from the time of the statute's enactment, if varying interpretations of the statute have created uncertainty. In those circumstances, the amendment has a retroactive effect. *Id.* at 322. This principle of statutory construction, set forth in *Detroit Edison Co v Janosz*, 350 Mich 606, 613-614; 87 NW2d 126 (1957), and reiterated in *Production Credit Ass'n of Lansing v Dep't of Treasury*, 404 Mich 301, 318-319; 273 NW2d 10 (1978), applies where no settled interpretation of the statute has been established and where the amendment was adopted soon after the controversy as to its interpretation arose—such as here. That timing indicates the amendment was a legislative interpretation of the original act rather than a substantial change of it. *Harper v Progressive Casualty Ins Co*, 79 Mich App 764, 768; 263 NW2d 1 (1977); 1A Sutherland, Statutory Construction (4th ed), § 22.31, p 276.

Furthermore, as the Legislature stated, and as we agree, the SBTA is remedial and procedural. The general rule that a statute is presumed to operate prospectively does not apply to statutes remedial or procedural in nature. *Selk v Detroit Plastic Products*, 419 Mich 1, 10; 345 NW2d 184 (1984), opinion on resubmission 419 Mich 32; 348 NW2d 652 (1984). Statutes in furtherance of an already existing remedy, which do not create new rights or destroy existing ones, operate retrospectively unless a contrary legislative intent is manifested. *Id.* at 10; *Spencer v Clark Twp*, 142 Mich App 63, 67; 368 NW2d 897 (1985).

The combination of these principles of statutory construction lead us to conclude that § 69 of the SBTA as amended by 1987 PA 39 has retroactive effect and is applicable to Trinova.

Because the Legislature has implicitly rejected the holding in *Jones & Laughlin*, and we do likewise explicitly, the Court of Claims decision was based upon incorrect principles of law. Thus, the case must be remanded for reconsideration under the proper principles. That is, as a pending matter, the case must be decided according to the amended § 69(3), which is a directive from our Legislature as to how the relief provisions of the SBTA are to be interpreted. The instant record does not permit us to judge what effect the two "fairness" tests contained in § 69(3) have on the position of the parties or the result in this case. Accordingly, the order of the Court of Claims granting Trinova summary disposition is reversed and the case remanded for development of additional facts and a new decision in light of amended § 69(3).

Reversed and remanded. We do not retain jurisdiction.

STATE OF MICHIGAN
IN THE COURT OF CLAIMS

File No. 86-10430-CM

HON. ROBERT HOLMES BELL

TRINOVA CORPORATION, (formerly LIBBEY-OWENS-FORD COMPANY),
Plaintiff,

—vs—

STATE OF MICHIGAN, DEPARTMENT OF TREASURY, REVENUE DIVISION,
Defendant.

OPINION AND ORDER OF THE COURT

This case presents an action by plaintiff, Trinova Corporation, to recover an alleged overpayment of taxes under the Single Business Tax Act. The Department of Treasury's answer thereto includes a counterclaim, asserting plaintiff actually owes additional tax for tax year 1980. Both parties have moved for summary disposition under MCR 2.116(C)(9), asserting their opponent has failed to state a valid defense.[1]

Plaintiff is an Ohio corporation which conducts business in Michigan. For the privilege of doing business in Michigan during tax year 1980, plaintiff paid tax under

[1] Normally, a motion for summary disposition under MCR 2.116(C)(9) is based exclusively on the pleadings. Here, however, both parties have asked the Court to also consider a document entitled "Stipulated Facts" in evaluating their motions. Pursuant to this mutual request, this document is herein treated as a pleading which speaks on behalf of both parties as to both claims before the Court.

the Single Business Tax Act ("Act"), MCL 208.1 *et seq.*; MSA 7.558(1) *et seq.* Plaintiff's tax liability for 1980 was computed through application of the Act's § 45 formula. Plaintiff paid this amount, $293,528, in full. In 1985, plaintiff filed an amended single business tax return, requesting the Department of Treasury ("Department") to re-calculate its 1980 tax liability by an alternate method. When the request was denied, plaintiff filed the instant complaint, asking the Court to rule that plaintiff is entitled to use the alternate method and to award a total tax refund of $293,528. In its counterclaim, the Department, too, asserts plaintiff's 1980 single business tax liability ought to have been calculated by an alternate method. According to its proposed method, plaintiff owes additional tax in the amount of $576,804.

I

The Act imposes a specific tax on the adjusted tax base of every person who conducts business in Michigan. The "adjusted tax base" is essentially federal taxable income, subject to certain additions and subtractions enumerated at § 9 of the Act. One of these "adjustments," at § 9(5), requires the taxpayer to add compensation paid its employees to its tax base. Similarly, § 9(4)(c) requires the taxpayer to add to its tax base any tangible assets depreciation deductions which had been subtracted in arriving at federal taxable income. Thus, compensation expenses and an amount equal to depreciation deductions previously taken become part of the adjusted tax base. In order to determine what portion of the adjusted tax base of a corporation like plaintiff, which conducts business within and without Michigan, is taxable as Michigan business activity, a three-factor apportionment formula is applied. Section 45 of the Act provides:

> All of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated,

> shall be apportioned to this state by multiplying the tax base by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3.

Application of this apportionment formula is designed to produce a reasonable *approximation* of that share of a multi-state taxpayer's business activity which is attributable to Michigan. Because the resultant approximation may be more or less accurate, depending on taxpayer-specific circumstances, relief from the apportionment formula is sometimes available under § 69 of the Act:

> (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the commission may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) Separate accounting.
>
> (b) The exclusion of any 1 or more of the factors.
>
> (c) The inclusion of 1 or more additional factors which will fairly represent the taxpayer's business activity in this state.
>
> (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.
>
> (2) An alternate method will be effective only if it is approved by the commissioner.

Plaintiff attempted to take advantage of this § 69 relief by filing an amended return which incorporated a two-step apportionment/allocation method. This method includes allocation of actual Michigan compensation expenses and actual Michigan depreciation amounts, rather than estimation thereof through apportionment. In other words, plaintiff excluded compensation and depreciation

amounts from its preapportionment adjusted tax base, contrary to § 9. The apportionment formula was applied to plaintiff's adjusted tax base less compensation and depreciation. Then, the known amounts of plaintiff's Michigan compensation and depreciation were added to the apportionment product to yield that portion of plaintiff's total business activity attributable to Michigan. The Department refused to approve this alternate two-step method even though the Tax Tribunal and the Court of Appeals had previously recognized it as legitimate and appropriate under similar circumstances. See *Jones & Laughlin Steel Corp v Dep't of Treasury*, 145 Mich App 405; 377 NW2d 397 (1985), *lv den* 424 Mich 894 (1986).

In defense of its decision, the Department contends the *Jones & Laughlin* ruling is not a binding precedent. The Department presents arguments based on other authorities which were largely rejected by the *Jones & Laughlin* court. Adjudication of plaintiff's claim depends almost exclusively upon the force and effect of *Jones & Laughlin*.

The Jones & Laughlin Steel Corporation and Wilson Foods Corporation filed single business tax returns for tax years 1976, 1977 and 1978, using the above-described two-step method. The Department refused to approve the method. The Tax Tribunal overruled the Department, holding (1) that the statutory apportionment formula failed to accurately represent the taxpayers' Michigan business activity; and (2) that the alternate two-step method yielded a substantially more accurate result. *Jones & Laughlin Steel Corp* v *Dep't of Treasury*, MTT Docket Nos. 57892 and 57893, Opinion & Judgment dated September 5, 1984. The Court of Appeals affirmed the Tax Tribunal judgment. Thus, the Court of Appeals' *Jones & Laughlin* ruling does not establish a broad rule of general applicability. It is merely an affirmance of the Tax Tribunal's treatment of two taxpayers under the Single Business Tax Act. Yet, while it may be in-

accurate to characterize *Jones & Laughlin* as "binding precedent," to the extent the instant fact situation is materially indistinguishable from the one treated in *Jones & Laughlin*, the Court of Appeals' reasoning certainly represents persuasive authority.

Both the Tax Tribunal's and the Court of Appeals' determination that application of the statutory apportionment formula yielded inaccurate results as to Jones & Laughlin Steel and Wilson Foods rested essentially upon two findings:

> (1) that each taxpayer's actual compensation expenses attributable to Michigan was a known amount; and
>
> (2) that application of the statutory apportionment formula to each taxpayer's total compensation expenses yielded an apportioned compensation approximation more than 50% greater than each taxpayer's actual Michigan compensation expenses for each tax year.

Where these two circumstances coincided, it was determined that application of the statutory apportionment formula was unfair, justifying § 69 relief.

Based on the pleadings, it appears both circumstances are present in the instant case as well, as to both compensation and depreciation. Plaintiff's 1980 apportioned Michigan compensation is approximately 40 times greater than actual compensation ($20,308,006 vs $511,774), while apportioned Michigan depreciation is approximately 1000 times greater than actual depreciation ($2,087,078 vs $2,152).

The Department has suggested no viable grounds for distinguishing *Jones & Laughlin* from plaintiff's case. Instead, the Department argues simply the *Jones & Laughlin* reasoning is defective and should be ignored. Contrary to *Jones & Laughlin*, the Department maintains

it is not enough to show that one or even two elements of a taxpayer's business activity are over-estimated by application of the Act's formula. Rather, the Department argues, the Act's formula should be departed from only if its application results in unfairly high or unfairly low taxation.

The *Jones & Laughlin* court addressed this argument directly as follows:

> The inquiry does not turn on the end result, i.e., tax liability. Rather, it turns on whether the basis for computing tax liability is fair, i.e., is the business activity subject to taxation accurately reflected by application of the three factor formula? 145 Mich App 412.

The Court of Appeals went on to hold that where even just one element of business activity is shown, by clear and convincing evidence, to be inaccurately represented by application of the apportionment formula, § 69 relief is available.

Whether this Court agrees entirely with this ruling is immaterial. It is this Court's function to interpret and apply the Single Business Tax Act in accordance with legislative intent and the pronouncements of the state's higher courts. Accordingly, the Court believes the Court of Appeals' *Jones & Laughlin* decision is entitled to more respect than the Department is willing to acknowledge. The Court hereby adopts the reasoning employed therein and holds as a matter of law based on the pleadings that the Act's apportionment formula fails to accurately represent plaintiff's Michigan business activity.

II

It follows that plaintiff is entitled to § 69 relief. However, an alternate method of calculating plaintiff's tax base is effective only if approved by the Department. It appears the Department never passed upon the appropri-

ateness of plaintiff's proposed alternate two-step method because it believed the Act's formula was suitable. When confronted with this situation in *Jones & Laughlin*, the Tax Tribunal noted the Department had not promulgated procedural rules whereby a proposed alternate method could be evaluated. The Tax Tribunal proceeded to establish and apply its own standard. It determined that a proposed method ought to be approved if it provides a "substantially more accurate representation" of the taxpayer's Michigan business activity. The Tax Tribunal determined in *Jones & Laughlin* that the two-step method varied from the Act's apportionment formula in one respect only: its treatment of Michigan compensation expenses. Since the two-step method substituted a known actual amount for an estimated inaccurate amount, the Tax Tribunal concluded the two-step method represented the taxpayer's Michigan business activity with substantially more accuracy than the Act's apportionment formula. Thus, the taxpayers were permitted to use the two-step method over the Department's objection. The Court of Appeals affirmed this result.

Here, the pleadings suggest similar treatment is justified. Applying the standard established in *Jones & Laughlin*, it is clear the Department should have approved plaintiff's proposed two-step method. It represents plaintiff's Michigan compensation and depreciation with substantially more accuracy than the Act's apportionment formula and does not further distort any other element of plaintiff's business activity. The Department has not disputed this fact, but objects to the resultant reduction in plaintiff's tax liability. Consistent with the Court of Appeals' rejection of this argument, the Court concludes the Department has failed to state a valid defense. Plaintiff's unrefuted allegation that the two-step method represents two elements of its business activity with substantially more accuracy than the apportionment formula justifies summary declaration in plaintiff's favor.

Whether plaintiff is entitled to refund of tax paid, however, is a question which depends in part upon resolution of the Department's counterclaim.

III

Although the Department, in defending against plaintiff's claim, contends the Act's formula does fairly represent plaintiff's 1980 Michigan business activity, its counterclaim asserts the contrary position. The Department alleges therein that application of the Act's formula fails to fairly represent (1) "the extent of Plaintiff's use of the State of Michigan as a market for its products;" and (2) "the significant amount of receipts which Plaintiff derives from its business activities in Michigan." The Department proposes an alternate method based solely upon plaintiff's Michigan sales. This method, too, is said to represent plaintiff's Michigan business activity substantially more accurately than the Act's apportionment formula. Asserting plaintiff has stated no valid defense to the claim, the Department moves for summary disposition in its favor.

Plaintiff admits its actual 1980 Michigan "sales," (gross receipts obtained in consideration for transfer of inventory to customers in the ordinary course of business and for performance of services), amounted to $103,981,354. Using the Act's formula, Michigan sales were estimated to be only $35,196,000. While admitting this circumstance may justify departure from the Act's formula, plaintiff contends the Department's proposed alternate method is not substantially more accurate. In fact, both parties acknowledge that use of the Department's proposed one-factor formula results in even more extreme exaggerations of plaintiff's Michigan compensation and depreciation than use of the Act's formula. (Stipulated Facts, pp 6, 7.) The very evil which the Tax Tribunal and Court of Appeals sought to avoid in *Jones & Laughlin*, taxation of extra-territorial business activity,

is thus compounded by use of the Department's proposed formula. This cannot be permitted. The Court must conclude the Department's proposed one-factor method does not represent plaintiff's business activity with substantially more accuracy than the Act's apportionment formula.

It must be remembered that the Act's apportionment formula has been recognized as the "preferred method established by the Legislature for determining the extent of a taxpayer's business activity in Michigan." *Payne & Dolan of Wisconsin, Inc* v *Dep't of Treasury*, 138 Mich App 418, 424; 360 NW2d 208 (1984). The two-step method proposed by plaintiff, *supra*, pays deference to this preference by departing therefrom minimally. It applies the Act's apportionment formula to all elements of plaintiff's tax base except compensation and depreciation. It further ensures that plaintiff's compensation and depreciation are even more accurately represented by allocating the actual amounts. While plaintiff's two-step method does not correct the underestimation of plaintiff's Michigan sales caused by use of the Act's formula, neither does it compound the distortion. Plaintiff's method does not represent its business activity with perfect exactitude, but it is superior to the Act's formula.

On the other hand, the Department's proposed alternate method represents a profound departure from the Act's formula. It replaces the legislatively preferred three-factor formula with a one-factor (sales) formula, eliminating the payroll and property factors from the equation. Not only does it appear to attach inordinate importance to plaintiff's sales, but it greatly distorts plaintiff's compensation and depreciation expenses. It is anything but an improvement upon the Act's formula.

The Court finds that plaintiff has stated a valid defense to the counterclaim. The Department's motion for summary disposition must be denied. Furthermore, the pleadings compel the conclusion that, as to the Department's counterclaim, there is no genuine issue of material fact. As a matter of law, the Court holds the Department's proposed alternate method is not substantially more accurate than the Act's formula. The Department is not entitled under § 69 of the Act to employ its proposed one-factor formula in determining plaintiff's single business tax. Plaintiff is entitled to summary disposition under MCR 2.116(I)(1).

IV

Based on the premises, the Department's counterclaim is hereby dismissed. Further, plaintiff is awarded summary disposition as to its claim under MCR 2.116(C)(9). The Department is hereby directed to accept and process plaintiff's amended single business tax returns for tax year 1980, refunding any overpayment and interest to which plaintiff is entitled.

IT IS SO ORDERED.

Dated: May 5, 1987

/s/ Robert Holmes Bell
ROBERT HOLMES BELL
Circuit Judge sitting in the
Court of Claims

STATE OF MICHIGAN
COURT OF CLAIMS

Civil Action No. 86-10430-CM

HON. ROBERT HOLMES BELL

TRINOVA CORPORATION, formerly
LIBBEY-OWENS-FORD COMPANY,
Plaintiff,

v

STATE OF MICHIGAN, DEPARTMENT OF TREASURY,
REVENUE DIVISION,
Defendant.

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STIPULATED FACTS

Plaintiff, Trinova Corporation, and defendant, State of Michigan, Department of Treasury, Revenue Division, through their attorneys, stipulate to the following facts:

1. Plaintiff is an Ohio corporation duly qualified under the laws of Michigan, with its principal office at 1705 Indian Wood Circle, Maumee, Ohio 43537. Plaintiff pays taxes to the State of Michigan pursuant to the Single Business Tax Act ("SBT"), [MCLA sec. 208.1 *et seq.*; MSA 7.588(1) *et seq.*]

2. Defendant is the State of Michigan, Department of Treasury, Revenue Division, which is the governmental agency charged with the administration of the SBT.

3. Because plaintiff has business activities which are taxable both within and without Michigan, its tax base is apportioned pursuant to SBT 41.

4. Plaintiff's Michigan activity in 1980 consisted of an office with six clerical workers to support eight sales people who solicited orders for plaintiff's glass division and provided liaison with its Michigan customers. More than one fourth of plaintiff's worldwide sales were made in Michigan.

5. Plaintiff contends that since its operations are nearly all located outside of Michigan, and are labor and capital intensive, the use of the standard statutory apportionment formula contained in the SBT 45 does not reasonably or fairly reflect the actual amount of plaintiff's business activity in Michigan.

6. For the purposes of the 1980 Michigan Single Business Tax, plaintiff's tax base was apportioned to Michigan based upon apportionment percentages determined pursuant to SBT 45 through 52. Plaintiff's tax base was multiplied by the SBT apportionment percentage for that year. The SBT apportionment percentage is a fraction, the numerator of which is the sum of the property factor (SBT 46), the payroll factor (SBT 49) and the sales factor (SBT 51), and the denominator of which is three.

7. The SBT apportionment percentage (the average of the property, payroll and sales factor percentages) was

determined by the defendant for the year 1980 as follows:

	1980
	%
Property Factor	.0930
Payroll Factor	.2328
Sales Factor	26.5892
Total Percentage	26.915
Apportionment %	8.9717
(Total percentage divided by three)	

8. Although the components of plaintiff's tax base include U.S. taxable income, compensation, depreciation, taxes, royalties, interest, etc., the amounts of compensation and depreciation, and the percentages of plaintiff's tax base composed of compensation and depreciation during the year 1980 were:

	1980
Tax Base:	$221,125,319
Total Compensation:	$226,356,271
Percentage of Tax Base:	102%
Total Depreciation:	$ 23,262,909
Percentage of Tax Base:	10.52%

9. The apportioned compensation compared to actual Michigan compensation, is as follows during the year 1980:

Total Compensation	Apportionment Percentage	Apportioned Compensation	Actual Michigan Compensation
$		$	$
226,356,271	8.9717	20,308,006	511,774

Actual Michigan compensation is 2.52% of the apportioned compensation.

10. The apportioned depreciation compared to actual depreciation is as follows for the year 1980:

Total Depreciation:	$23,262,909
Apportionment Percentage:	8.9717
Apportioned Depreciation:	$ 2,087,078
Depreciation Attributable to Michigan:	$ 2,152

Depreciation attributable to Michigan is .1% of depreciation apportioned to Michigan.

11. *Jones & Laughlin Steel Corporation* v *Michigan Department of Treasury* and *Wilson Foods Corporation* v *Michigan Department of Treasury*, 145 Mich App 405 (1985); app *lv den*, 484 Mich 894 (1986) motion for reconsideration *den*, Michigan Supreme Court No. 77291 & 77292 (October 22, 1986) approves an SBT 69 alternative method of apportionment and allocation. It offered relief to two taxpayers whose compensation attributable to Michigan was identifiable and overapportioned to Michigan under the three factor formula. Under this method the three factor apportionment percentage was applied to the taxpayer's SBT 9 tax base excluding compensation. To the apportioned amount was added the full amount of actual Michigan compensation.

12. On or about October 13, 1985, plaintiff timely filed with the defendant an Amended Single Business Tax Annual Return for the year 1980, plus a request that plaintiff be allowed to utilize the method of allocation and apportionment endorsed in *Jones & Laughlin, supra*, pursuant to the SBT 69 relief provisions. The amended returns reflect the application of the SBT 69 alternative method of apportionment and allocation set forth in *Jones & Laughlin, supra*, and a refund request of $293,528.

13. Application of plaintiff's alternative method would lead to an overpayment of single business tax for 1980 in the amount of $293,528, which is the entire amount of tax paid for 1980.

14. On November 12, 1985 the defendant denied plaintiff's request for SBT 69 relief and refund.

15. SBT section 69 provides that an alternate method will be effective only if it is approved by the Commissioner.

16. Plaintiff's sales for 1980, which are precisely identified, were as follows:

Total Sales:	$391,065,866
Sales in Michigan:	$103,981,354
Percentage of Michigan Sales to all Sales:	26.5892%

17. Apportioned sales, under the three factor formula, compared to actual sales in Michigan for the year 1980 are as follows:

Total Sales	$391,065,866
Apportionment Percentage	8.9717
Apportioned Sales	$ 35,196,000
Actual Michigan Sales	$103,981,354

Sales attributable to Michigan are 33.8% of actual Michigan Sales and under plaintiff's proposal would remain so even though attributed compensation would be 100% of Michigan compensation.

18. The defendant's proposed alternative method of calculating plaintiff's single business taxes by use of a one factor formula consisting of a sales factor would be computed as follows:

Tax Base:	$221,125,319
X Sales Factor:	26.5892%
Apportioned Tax Base:	$ 58,795,453
Less Capital Acquisition deduction:	$ 9,063
Adjusted Tax Base:	$ 58,786,390
Less 37% Compensation deduction:	$ 21,750,964
Taxable Amount:	$ 37,035,426
Tax at 2.35%:	$ 870,332

19. Application of the one factor formula consisting of the sales factor would apportion plaintiff's compensation to Michigan as follows:

1980 Total Compensation:	$226,356,271
Actual Michigan Compensation:	$ 511,774
Compensation Apportioned to Michigan:	$ 60,186,322
Percentage of total Compensation to Michigan Apportioned Compensation:	26.6%

This percentage is the same as the percentage of the plaintiff's sales in Michigan to total sales.

20. Application of the one factor formula consisting of the sales factor would apportion plaintiff's depreciation to Michigan as follows:

1980 Total Depreciation:	$23,262,909
Depreciation Attributable to Michigan:	$ 2,152
Depreciation Apportioned to Michigan:	$ 6,185,421
Percentage of total Depreciation to Michigan Apportioned Depreciation:	26.6%

This percentage is the same as the percentage of the plaintiff's sales in Michigan to total sales.

21. Application of defendant's alternative method would lead to an underpayment of single business tax for 1980 in the amount of $576,804.

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Dated: _____

STATUTORY PROVISIONS

Mich. Comp. Laws § 208.42 (1979). Conditions to taxpayer being taxable in another state.

Sec. 42. For purposes of apportionment of the tax base from business activities under this act, a taxpayer is taxable in another state if, (a) in that state he is subject to a business privilege tax, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax, a tax of the type imposed under this act, or (b) that state has jurisdiction to subject the taxpayer to 1 or more of the taxes regardless of whether, in fact, the state does or does not.

Mich. Comp. Laws § 208.45 (1979). Computation of tax base apportioned for state.

Sec. 45. All of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3.

Mich. Comp. Laws § 208.46 (1979). Property factor.

Sec. 46. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented in this state during the tax year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented during the tax year.

Mich. Comp. Laws § 208.49 (1979). Payroll factor; "wages" defined.

Sec. 49. The payroll factor is a fraction, the numerator of which is the total wages paid in this state during the tax year by the taxpayer and the denominator of

which is the total wages paid everywhere during the tax year by the taxpayer. For the purposes of this chapter only, "wages" means wages as defined in section 3401 of the internal revenue code.

Mich. Comp. Laws § 208.51 (1979). Sales factor.

Sec. 51. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year, and the denominator of which is the total sales of the taxpayer everywhere during the tax year.

Mich. Comp. Laws § 208.69 (1979). Apportionment not fairly representing extent of taxpayer's business activity in state.

Sec. 69. (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the commissioner may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting.

(b) The exclusion of any 1 or more of the factors.

(c) The inclusion of 1 or more additional factors which will fairly represent the taxpayer's business activity in this state.

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

(2) An alternate method will be effective only if it is approved by the commissioner.

Mich. Comp. Laws Ann. § 208.69 (West 1979). Relief as to tax base (as amended by 1987 Pub. Act 39)

Sec. 69. (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's

business activity in this state, the taxpayer may petition for or the commissioner may require the following, in respect to all or a part of the taxpayer's business activity, if reasonable:

(a) Separate accounting.

(b) The exclusion of 1 or more of the factors.

(c) The inclusion of 1 or more additional factors which will fairly represent the taxpayer's business activity in this state.

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

(2) An alternate method will be effective only if it is approved by the commissioner.

(3) The apportionment provisions of this act shall fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of the tax base such as depreciation, compensation, or income, unless it can be demonstrated that the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business transacted in this state and leads to a grossly distorted result. A taxpayer's business activity shall be presumed to be fairly represented if the adjusted tax base computed without regard to the reduction based upon gross receipts permitted by section 31(2) is not greater than the adjusted tax base computed after application of the reduction based upon gross receipts permitted by section 31(2) or if the adjusted tax base is not greater than the adjusted tax base which would result from an apportioned tax base computed by using the apportionment formula prescribed for a corporate income tax or franchise tax in the taxpayer's business domicile. The taxpayer's business domicile is the state in which the sum of the tax-

payer's payroll factor and property factor is greatest. However, if the taxpayer fails to satisfy either of these tests, the taxpayer's business activity shall not be presumed to not be fairly represented.

(4) The filing of a return or an amended return shall not be considered a petition for the purposes of subsection (1).

(5) As used in this section, "adjusted tax base" means that term as defined in section 31.

Amended by P.A.1987, No. 39, § 1, Imd. Eff. June 9.

MICHIGAN COURT OF APPEALS

Docket Nos. 80472, 80473

JONES & LAUGHLIN STEEL CORPORATION

v.

DEPARTMENT OF TREASURY

WILSON FOODS CORPORATION

v.

DEPARTMENT OF TREASURY

Submitted June 10, 1985, at Lansing

Decided September 3, 1985

Leave to appeal applied for

Jones & Laughlin Steel Corporation and Wilson Foods Corporation each petitioned the Tax Tribunal for relief from single business tax assessments made by the Department of Treasury against them. The Tax Tribunal consolidated the petitions. Both petitioners are incorporated in foreign states and have their principal places of business in foreign states. Their products are sold throughout the United States. Jones & Laughlin operates a marketing and sales office, a manufacturing plant, and

a retail outlet in Michigan. Wilson Foods operates marketing and sales offices and utilizes certain salesmen in Michigan. They claimed that application of the statutory three-factor formula for apportionment distorted the business activity of the petitioners in the state and that they were thus entitled to an alternative method of apportionment provided for by statute. The Treasury Department contended that they would only be entitled to relief if the final tax liability was out of proportion to the petitioners' business activity in the state. The Tax Tribunal held that the petitioners were entitled to the requested relief. The Treasury Department appealed. *Held:*

The proper test for determining whether the apportionment provisions of the Single Business Tax Act fairly represent the extent of the taxpayer's business activity in the state, thus allowing the use of an alternative method of allocation, is whether the statutorily prescribed method of apportionment accurately reflects the extent of the taxpayer's business activity in the state.

Affirmed.

1. TAXATION—SINGLE BUSINESS TAX—APPORTIONMENT—ALTERNATIVE METHODS OF APPORTIONMENT—FAIRNESS—BURDEN OF PROOF.

The proper test for determining whether the apportionment provisions of the Single Business Tax Act fairly represent the extent of the taxpayer's business activity in the state, thus allowing the use of an alternative method of allocation, is whether the statutorily prescribed method of apportionment accurately reflects the extent of the taxpayer's business activity in the state; the burden of proving distortion of business activity in the state by use of the statutorily prescribed apportionment method is upon the party seeking to use an alternative method.

2. TAXATION—SINGLE BUSINESS TAX.

The single business tax is a levy on the privilege of doing business in the state.

Dickinson, Wright, Moon, Van Dusen & Freeman (by *Peter S. Sheldon*), for appellees.

Frank J. Kelley, Attorney General, *Louis J. Caruso*, Solicitor General, and *Richard R. Roesch* and *Charles E. Liken*, Assistants Attorney General, for the Department of Treasury.

OPINION OF THE COURT

Before: MACKENZIE, P.J., and HOOD and J.E. MIES,* JJ.

MACKENZIE, P.J. Respondent appeals as of right from a judgment of the Michigan Tax Tribunal cancelling assessments of single business tax deficiency issued by respondent against petitioners. We affirm.

Jones & Laughlin Steel Corporation and Wilson Foods Corporation are incorporated in foreign states and have their principal places of business in foreign states. Their products are sold throughout the United States. Jones & Laughlin operates a marketing and sales office, a manufacturing plant, and a retail sales outlet in Michigan. Wilson Foods operates marketing and sales offices and utilizes certain salesmen in Michigan.

The Single Business Tax Act, MCL 208.1 *et seq.*; MSA 7.558(1) *et seq.*, imposes a specific tax on the adjusted tax base of every person with business activity in this state. *Town & Country Dodge, Inc. v Dep't of Treasury*, 420 Mich 226, 234-235; 362 NW2d 618 (1984); MCL 208.31(1); MSA 7.558(31)(1). "Adjusted tax base" is essentially federal taxable income, subject to certain additions and subtractions enumerated at MCL 208.9; MSA

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* Circuit judge, sitting on the Court of Appeals by assignment.

7.558(9). One of these "section 9 adjustments" to the tax base requires the taxpayer to add compensation paid its employees to taxable income. MCL 208.9(5); MSA 7.558(9)(5).

Since petitioners have taxable business activities both within and without Michigan, determination of their single business tax liability requires that each apportion its adjusted tax base to reflect Michigan activity. See MCL 208.41; MSA 7.558(41). Apportionment is achieved by applying to the adjusted tax base a three-factor formula:

> "All of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3." MCL 208.45; MSA 7.558(45).

The three-factor formula produces an apportionment percentage of the taxpayer's business activity attributable to Michigan. By multiplying the taxpayer's adjusted tax base by this apportionment percentage, the taxpayer's Michigan tax base is computed.

Application of the apportionment percentage derived from the statutory formula to petitioners' actual total compensation paid their employees in Michigan yielded a value far in excess of actual compensation paid. During 1976, for example, the actual compensation paid in Michigan by Wilson Foods was $91,642, whereas its apportioned compensation was $2,975,400. Accordingly, from 1976 to 1978, in lieu of calculating their Michigan tax base as provided by the statutory apportionment formula, both petitioners used a two-step apportionment/allocation calculation. First, each petitioner applied the statutory three-factor apportionment formula to its adjusted tax base exclusive of the § 9 compensation adjustment. Second, they allocated the exact amount of compensation paid which was attributable to Michigan. From this sum, they determined their single business tax liability.

Pursuant to audits conducted by respondent, petitioners' single business tax for the years 1976-1978 was recalculated by including compensation as part of each petitioners' adjusted tax base and applying the statutory apportionment formula. Using this method, respondent assessed deficiencies of $556,697 and $37,694 against Jones & Laughlin and Wilson Foods, respectively.

The Tax Tribunal ordered the cancellation of the assessed deficiencies pursuant to § 69 of the Single Business Tax Act, which provides in relevant part:

> "(1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the commissioner may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> * * *
>
> "(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base." MCL 208.69; MSA 7.558(69).

The sole issue before this Court is whether on these facts petitioners were entitled to § 69 relief. What constitutes "fairness" for purposes of this section is a question of first impression. Respondent contends that fairness is tested by weighing the reasonableness of the taxpayer's final tax liability against the level of its business activity within the state, citing *Armco Steel Corp v Dep't of Revenue*, 359 Mich 430; 102 NW2d 552 (1960), *app dis* 364 US 337; 81 S Ct 124; 5 L Ed 2d 99 (1960).

The problem with respondent's proposed test is that it does not focus on the fairness of the *apportionment* provisions of the act, for which § 69 is designed to provide relief. We believe instead that the proper test for invoking § 69 relief is whether the taxpayer's Michigan tax base, as derived from the application of the three-factor apportionment formula to its adjusted tax base, accurately reflects the extent of the taxpayer's business activity within the state.

Section 69 is, for pertinent purposes, identical to the relief provision of the Income Tax Act of 1967, alternatively referred to as the Michigan corporate income tax, see MCL 206.195; MSA 7.557(1195), and the provision affording relief from the apportionment formula which was once used in determining franchise fees, see MCL 450.305(5); MSA 21.208(5), repealed by 1975 PA 230, § 1. The single business tax is, and the franchise fee was, a levy on the privilege of doing business in the state. *Acco Industries, Inc v Dept of Treasury*, 134 Mich App 316; 350 NW2d 874 (1984), *lv den* 421 Mich 856 (1985); *International Telephone & Telegraph Corp v Michigan*, 50 Mich App 5; 213 NW2d 226 (1973), *lv den* 391 Mich 774 (1974). Although the corporate business income tax is a tax on income, "the logic employed by the court [in interpreting the relief provision of the Michigan corporate income tax] should be equally applicable to the single business tax since similar provisions exist for combined filing". Weithorn & Zartarian, *Taxation: State and Local*, 30 Wayne Law Review 789, 790 (1984). Thus, we look to interpretations of the relief provisions found in those statutes to determine what is meant by the proviso that "the apportionment provisions * * * do not fairly represent the extent of the taxpayer's business activity in this state".

In *Donovan Construction Co v Dep't of Treasury*, 126 Mich App 11; 337 NW2d 297 (1983), *lv den* 419 Mich 894 (1984), the Treasury Department requested that

plaintiff's corporate income tax be computed through a separate accounting method, which method would yield a greater tax liability than the statutory three-factor apportionment formula. The Department argued that the apportionment formula resulted in a "gross disparity" in tax liability. This Court upheld use of the apportionment formula, stating:

> "Only if formulary apportionment does not fairly represent the extent of the taxpayer's business activity in the state may a different method, such as separate accounting, be employed. The party seeking to employ an alternate apportionment method has the burden of showing that the formulary apportionment method is inappropriate by clear and convincing evidence. * * * Evidence introduced to overcome the formula method of allocation must address each element of the formula's equation." 126 Mich App 21-22.

Elucidating on the type of showing which must be made, this Court stated:

> "[A]pplication of the separate accounting [or some other alternative formula] solely on the basis that there is a gross disparity in the results between the different methods results in the use of the separate accounting because the tax liability is greater and not because separate accounting more accurately reflects the corporate taxpayer's unitary business in the state. This Court is of the opinion that, *in addition to the gross disparity between the results, additional evidence should be considered in demonstrating that the statutory formula inadequately or inaccurately represents the taxpayer's unitary business activity in the taxing state*". 126 Mich App 21, fn 2. (Emphasis added.)

In *Payne & Dolan of Wisconsin, Inc v Dep't of Treasury*, 138 Mich App 418; 360 NW2d 208 (1984), the

Treasury Department also contended that for corporate income tax purposes the separate accounting method more fairly represented the taxpayer's business activities in Michigan. The basis of the contention was again the "gross disparity" between petitioner's taxable income under the apportionment formula and the separate accounting method. This Court rejected the argument, stating:

> "To permit respondent to meet its burden by merely pointing to a 'gross disparity' between taxable income under the separate accounting method as compared with taxable income under the apportionment formula would necessarily involve a presumption that the separate accounting method is a more accurate means of determining a taxpayer's business activity in Michigan than is the apportionment formula. We concur with the *Donovan* panel that *to meet its burden the state must show that the statutorily-preferred apportionment formula is itself inadequate as a means of fairly determining the particular taxpayer's extent of business activity in Michigan*". 138 Mich App 424. (Emphasis added.)

In *Donovan* and *Payne & Dolan*, the Treasury Department based its requests for relief primarily on a showing of gross disparity in tax liability results and not on a showing that the apportionment formula distorted business activity within the state. Therefore, this Court denied relief. Similarly, because the burden of showing distorted activity was not met in *International Telephone & Telegraph Corp, supra*, the corporation was not entitled to relief in computing franchise fees. The basis for denial or relief in these cases was *not*, as respondent suggests, that the resulting franchise fee or tax liability seemed reasonable or not excessive. The inquiry does not turn on the end result, *i.e.*, tax liability. Rather, it turns on whether the basis for computing tax liability

is fair, *i.e.*, is the business activity subject to taxation accurately reflected by application of the three-factor formula?

This Court reviews Tax Tribunal decisions to determine whether such decisions are authorized by law and whether they are supported by competent, material, and substantial evidence on the whole record. *Terco, Inc. v Dep't of Treasury*, 127 Mich App 220, 223; 339 NW2d 17 (1983); Const 1963, art 6, § 28. Based on *Donovan, Payne & Dolan*, and *International Telephone & Telegraph Corp, supra*, it is clear that the Tax Tribunal's analysis was based on an accurate statement and understanding of the law. Both the Single Business Tax Act and similar provisions in other acts permit relief if business activity within the state is distorted by the apportionment formula. Therefore, the Tax Tribunal's decision granting relief will be upheld if the evidence regarding business activity supports its determination.

The parties stipulated below that (1) 85 percent to 100 percent of the petitioners' adjusted tax bases were comprised of compensation; (2) use of the apportionment formula indicated that the compensation was $12,000,000 to $17,000,000 higher than actual compensation for Jones & Laughlin and $2,000,000 higher than actual compensation for Wilson Foods for each of the three years in question; and (3) the compensation attributable to Michigan could be precisely calculated for both corporations. Petitioners did not merely show a gross disparity in tax liability depending on the accounting method employed. Instead, based on the stipulated facts, petitioners presented evidence which demonstrated that the three-factor formula over-apportioned or excessively attributed compensation to Michigan. The facts revealed that the compensation component of business activity subject to taxation was overstated by approximately 50 percent. As required by *Donovan, supra*, p 21, fn 2, petitioners pre-

sented clear and convincing evidence "that the statutory formula inadequately or inaccurately represent[ed] [their] unitary business activity in the taxing state". We thus conclude that the decision of the Tax Tribunal was authorized by law and supported by competent, material, and substantial evidence on the whole record.

Affirmed.

[SEAL]

STATE OF MICHIGAN
OFFICE OF THE GOVERNOR
Lansing

James J. Blanchard
Governor

IN THE SUPREME COURT OF THE
STATE OF MICHIGAN

EXECUTIVE MESSAGE OF JAMES J. BLANCHARD, GOVERNOR

To: The Honorable Chief Justice and Associate Justices of the Michigan Supreme Court

James J. Blanchard, Governor of the State of Michigan, pursuant to MCR 7.305(A), respectfully advises the Court as follows:

I. *Introduction.*

One of the primary purposes of the Michigan Single Business Tax ("SBT"), when enacted, "was to promote the development and investment of business within Michigan."[1] In direct contravention of that legislative intent, the Michigan Court of Appeals recently decided a case which interpreted the SBT in such a way as to reward taxpayers who locate job-creating activities outside of Michigan and which penalizes those employers who increase employment within the State.

That decision by the Michigan Court of Appeals is *Jones & Laughlin Steel Corp* v *Treasury Dept*, 145 Mich App 405, 377 NW2d 397 (1985), *lv den* 424 Mich 895

[1] *See ACCO Industries* v *Treasury Dept*, 2 CCH Mich St Tax Rpts ¶ 200-983, page 10,553, 10,557 (Michigan Tax Tribunal, 1983), *aff'd* 134 Mich App 316; 350 NW2d 874 (1984).

1986), (hereinafter referred to as "*J&L*"). The Michigan Department of Treasury, with the support of the Motor Vehicle Manufacturers Association, asked your Court to review the *J&L* decision on the grounds that the decision was clearly erroneous as a matter of law and represented a serious threat to Michigan's economic recovery. The Court, with two Justices dissenting, declined to hear the case.

The Court of Appeals' decision in *J&L* has created confusion and chaos for taxpayers and taxing authorities alike. The Michigan Deparement of Treasury continues to believe that *J&L* is not good law. Nevertheless, corporate taxpayers which are based outside of Michigan and which are able to take advantage of the *J&L* rationale, because the majority of their work force is located out-of-state, have flooded the courts with claims for refund. As of the date of this Executive Message, nearly 300 cases involving over $96,000,000 are pending.

As shown by several recent lower court decisions, including *AMP, Inc* v *Treasury Dept*, Court of Claims No 86-10216-CM ("AMP"), the lower courts view *J&L* as a "per-se" rule to be applied as a matter of law.[2] The *AMP* decision has been appealed by the Michigan Department of Treasury and now is pending before the Michigan Court of Appeals.[3] For reasons which are more fully detailed below, I believe it is imperative that the Supreme Court review the rationale underlying the *J&L*

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[2] In *Trinova Corp* v *State of Mich*, Court of Claims No. 86-10430-CM, the Court in its opinion "adopts the reasoning employed therein [*J&L* decision] and holds AS A MATTER OF LAW . . . that the [SBT] Act's apportionment formula fails to accurately represent plaintiff's Michigan business activity." (Bracketed material added; emphasis supplied).

[3] Michigan Court of Appeals Docket No. 100512.

AMP produces electrical and electronic connection devices, is headquartered in Harrisburg, PA, and has approximately 22,000 employees in the U.S. and 25 other countries.

and *AMP* decisions. Accordingly, I am asking in this Executive Message that the Supreme Court authorize the Michigan Court of Appeals to certify the controlling question of law presented by the *AMP* case.

On June 9, 1987 I signed into law 1987 PA 39 which was passed unanimously by both the Michigan Senate and House of Representatives. This legislation (attached hereto as Exhibit A) responds to the *J&L* rationale by declaring as the Legislature's intent that the SBT "is an indivisible value added type of tax and not a combination or series of several smaller taxes and that relief from formulary apportionment should be granted only under extraordinary circumstances."

The Act declares that the apportionment provisions of the SBT "fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of the tax base such as depreciation, compensation, or income, unless it can be demonstrated that the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business transacted in this state and leads to a grossly distorted result." The Act sets forth two quantitative tests to be employed in determining if the statutory apportionment provisions result in fair attribution of business activity.

In Section 2 of Act 39, the Legislature declares that its provisions are "curative, expressing the original intent of the legislature . . .".

It appears obvious that the Legislature sought to put an end to the flood of *J&L* litigation by declaring its unmistakable intent that the SBT shall be treated as a tax upon business activities, not as taxes upon elements of the tax base. I believe that *J&L* and *AMP* were wrongly decided even under prior law. 1987 PA 39 provides further evidence that the lower courts have erred in their construction of the apportionment issue.

Yet, many litigants which rely upon the *J&L* rationale postulate in their pleadings that the apportionment method upheld in *J&L* is constitutionally mandated and that the apportionment provisions of the SBT are constitutionally defective. These postulates will generate prolonged litigation.

II. *Background.*

The Michigan Single Business Tax is a modified "value added" tax. As such, the SBT is not designed to tax what the taxpayer derives from the economy (*i.e.*, income) but, rather, is designed to tax the value added by the taxpayer to the economy. Consistent with the value added nature of the SBT, a taxpayer's tax base is computed by starting with its net income from all operations and then adding such items as total compensation, royalties, interest, etc., all of which reflect value added to a product or service. For a multistate taxpayer, that tax base may be described as a "universal tax base" because it reflects the multi-state taxpayer's operations both within and without Michigan. For such a taxpayer, computing its universal tax base is only the first step in determining its SBT liability. The multi-state taxpayer normally applies a standard three-factor apportionment formula to determine the fraction of its universal tax base which will be subject to Michigan tax. The resulting number is referred to herein as the "Michigan tax base." and that is the figure ultimately used to compute the taxpayer's SBT liability.

The standard "three-factor" apportionment formula is based on the ratio of the taxpayer's property, payroll and sales in Michigan to its property, payroll and sales everywhere. That apportionment formula has been used throughout the United States for many years as an appropriate way of apportioning, for a variety of tax purposes, a multistate taxpayer's business activity among different states.

In the unusual event that the apportionment provisions of the SBT "do not fairly represent the extent of the taxpayer's business activity in" Michigan, Section 69 of the SBT Act, MCL 208.69; MSA 7.558(69), authorizes the use of other methods to produce an equitable allocation and apportionment of tax base. In *J&L*, despite the absence of any showing that the statutory apportionment formula of the SBT did "not fairly represent the extent of the taxpayer's business activity in" Michigan, the Court of Appeals nevertheless allowed the taxpayer to ignore the traditional three-factor formula and substitute its own formula.

The formula devised by the taxpayer and approved by the Court of Appeals in *J&L*, and followed by the Court of Claims in *AMP*, treats compensation differently than all other elements of the SBT universal tax base. In *J&L*, rather than the taxpayer including compensation in its universal tax base and then applying the statutory three-factor formula to determine its Michigan tax base, the taxpayer was allowed to use the following procedure:

1. The taxpayer's universal tax base was computed *excluding* compensation, and then was apportioned to Michigan using the statutory three-factor formula.

2. The taxpayer then added to the resulting figure its Michigan payroll and a portion of fringe benefits (i.e., that percentage of all fringe benefits which corresponds to the percentage which the Michigan payroll bears to all payroll) to determine its Michigan tax base.

In short, the taxpayer was allowed to compute its Michigan tax base by first apportioning in the statutory manner all elements of its universal tax base except compensation, and then allocating (*i.e.*, simply plugging-in) its Michigan direct payroll plus a portion of fringe benefits. Because the taxpayer in J&L employed a substantial majority of its workforce outside the State of Michigan, its SBT liability was significantly reduced by the use of that procedure.

III. *The implication of J&L, AMP and related decisions are contrary to the best interests of the State's economy and to the policies underlying the enactment of the SBT*

To date, the *J&L* rationale has been applied only to reduce the tax liability of taxpayers such as Jones & Laughlin and AMP Incorporated which are based outside the State of Michigan. The Michigan Department of Treasury now is asserting in a counterclaim filed in litigation pending between General Motors Corporation and the Michigan Department of Treasury, that the *J&L/AMP* rationale, if constitutionally mandated, should be applied to significantly increase the SBT liability of taxpayers like GM who have large workforces in the State of Michigan.[4] In its counterclaim against GM the Treasury contends, pursuant to the *J&L* rationale, that GM is liable for additional single business tax of approximately $45 million per year.

If the rationale underlying *J&L* and *AMP* were extended as suggested by the Treasury in its lawsuit against GM, major Michigan-based employers would, like GM, be adversely affected. The decision would have the practical effect of substantially converting the SBT into a tax on *Michigan* payrolls. Accordingly, any increase in Michigan payrolls would cause a large, directly allocated increase in Michigan tax base and, consequently, in SBT liability. Conversely, if the taxpayer expanded its activity instead in another state with a traditional income tax, its Michigan tax base would decrease in proportion to the increased out-of-state payroll. Moreover, because in a traditional income tax system the additional compensation paid in the other state would be a tax deduction, the taxpayer would gain a significant tax advantage in the other state where the expanded activity was lo-

[4] That lawsuit is titled *General Motors Corp and Combined Subsidiaries* v *State of Michigan, Treasury Dept, Revenue Div*, Court of Claims No. 83-8995-CZ.

cated. Thus, *J&L AMP* create a strong disincentive to locating in Michigan any new or expanded business activity which includes significant employment. Similarly, the decisions in those cases amount to a judicially created tax incentive to move labor-intensive activities outside of Michigan.

Such a result is clearly contrary to one of the primary purposes of the SBT, namely to promote the development and investment of business *within* Michigan. Indeed, the rationale of *J&L* stands that legislative purpose on its head by rewarding taxpayers which locate job-creating activities outside of Michigan and penalizing those increasing employment within the State.

IV. *A prompt resolution of this issue is critical for efficient administration of the Single Business Tax Act.*

The *J&L* decision prompted a flood of refund claims by out-of-state companies. The most recent available data reveal:

1. 296 lawsuits are pending in the Tax Tribunal, Court of Claims, and Court of Appeals involving *J&L* type claims and new lawsuits are constantly being filed.

2. Many other taxpayers have had refund claims denied by the Treasury Department, but have not yet filed suit.

3. Numerous other taxpayers have simply filed SBT returns using the *J&L* rationale, without seeking permission in advance from the Department of Treasury.

4. The total dollar value of the refund claims now in litigation already is $96,104,625, exclusive of interest.

5. Robert A. Bowman, State Treasurer, testified before the Michigan Senate Finance Committee that application of the *J&L* rationale in computing the SBT liability of 19 major Michigan-based taxpayers would result in assessments exceeding $350 million.

This deluge of refund claims and litigation not only threatens the viability of the State's budget, but has imposed a tremendous burden on Michigan's Treasury, its counsel and the court system in attempting to deal with the volume of claims.

There are approximately 7,000 multi-state taxpayers doing business in Michigan who use apportionment in computing their SBT liability. If *J&L* is good law and if the rationale of that case may be extended as suggested by the Treasury in its lawsuit against GM, then the SBT tax liability for the majority of those 7,000 multi-state taxpayers must be recomputed; either upward, in the case of GM and other firms having a significant portion of their work force in Michigan, or downward, in the case of AMP Incorporated and other firms which have a relatively small percentage of their workforces in Michigan.

Thus, wholly apart from the highly significant budgetary and business climate considerations discussed above, *J&L* is an administrative nightmare. If *J&L* was correctly decided and if its attribution method is mandated on constitutional grounds, the Treasury must proceed immediately to compute and issue either refunds or assessments covering several tax years to thousands of taxpayers. The Treasury, however, firmly believes that *J&L* is not good law. Clearly, the Treasury and the state's taxpayers need immediate guidance from the Michigan Supreme Court in this critical issue.

V. *The controlling legal issue.*

In deciding *J&L*, *AMP* and related cases, the courts have focused primarily on a comparison of two figures.

1. "Apportioned compensation," which represents the taxpayer's total compensation both within and without Michigan, multiplied by the statutorily determined percentage; and

2. "Actual Michigan compensation," which in reality is simply the taxpayer's total compensation multiplied by the Michigan wage factor.[5]

In J&L, the Court of Appeals allowed a taxpayer to invoke the relief provisions of Section 69 of the Act based on a finding that the taxpayer's "apportioned compensation" was roughly 50% greater than the taxpayer's "actual Michigan compensation".[6] In *AMP* the Court of Claims granted summary disposition in favor of the taxpayer ". . . finding that application of the statutory three-factor apportionment formula against the compensation component of Plaintiff's tax base excessively attributes compensation to Michigan by more than 350% . . . ."

The pertinent facts of *AMP* are summarized in the attached Exhibit B. As shown in that Exhibit, for the five years in which the Court of Claims granted relief the taxpayer's SBT liability was reduced as follows:

	1980	1981	1982	1983	1984
SBT Liability w/o Section 69 Relief	48,195	53,952	51,846	53,462	64,151
SBT Liability with Section 69 Relief	22,158	27,301	26,763	25,721	25,969

[5] The SBT Act defines "compensation" to include such items as pension and profit sharing benefits, health insurance benefits, etc. MCL 208.4; MSA 7.558(4). The figures cited by the lower courts as "actual Michigan compensation" are Michigan wages plus fringe benefits apportioned to Michigan by use of the payroll factor. The same figure of "actual Michigan compensation" results from multiplying total compensation by the Michigan percentage of payroll.

[6] For taxpayers based outside of Michigan which maintain a relatively small workforce here and essentially use Michigan as a market for their goods, it is not at all unusual for "apportioned compensation" to exceed by 50%, or much more, the "actual compensation" in Michigan. It is precisely because that situation is commonplace that the courts have been flooded with *J&L* type claims for refunds.

Reduction in tax	26,037	26,651	25,083	27,741	38,182
AMP's Michigan Receipts (sales)	9,912,389	10,390,067	9,819,458	11,315,584	14,779,181
AMP's SBT Liability (w/o relief) Expressed as a % of its Michigan business receipts	.4862%	.5193%	.5280%	.4725%	.4341%

The history of the relief provisions originally incorporated in the Uniform Division of Income for Tax Purposes Act (UDITPA), and as included in the SBT Act as Section 69, shows that it was intended to provide an avenue for relief from the statutory apportionment formula only in those rare and unusual instances when application of the formula produced an unreasonable or unconstitutional result.

The decisions in *J&L*, *AMP* and related cases simply are wrong because the taxpayers' *overall* tax liability in those cases was not disproportionate to the taxpayers' *overall* business activity in Michigan, and because no showing has been made by any of the involved taxpayers that their circumstances were in any way unique and unusual.

I have determined that the pending Michigan Court of Appeals' *AMP* litigation involves a controlling question of law which is of such public importance as to require an early determination by the Supreme Court. Therefore, pursuant to MCR 7.305 I am, by this Executive Message, respectfully requesting the Supreme Court to authorize the Michigan Court of Appeals to certify the following question to it for immediate determination:

In the absence of a showing by AMP Incorporated that its overall tax liability was disproportionate to its overall

business activity in Michigan, did the Court of Claims properly allow AMP to invoke the relief provisions of Section 69 of the Single Business Tax Act to reduce its SBT tax liability?

VI. *Additional relief requested.*

Because of the overriding importance of this matter to the State of Michigan, its multi-state taxpayers and the functioning of the court system, I would urge that the Supreme Court expedite the hearing on this question by scheduling an early briefing and argument date. I would also ask of this Court that it issue an order directed to the Court of Appeals, Court of Claims and Michigan Tax Tribunal ordering each of them to entertain and grant where appropriate motions for stays of proceedings in all cases involving the issue here involved. A current list of the cases now before the lower forums is attached hereto as Exhibit C.

Respectfully submitted,

/s/ James J. Blanchard
JAMES J. BLANCHARD,
Governor

November 6, 1987

STATE OF MICHIGAN
IN THE CIRCUIT COURT
FOR THE COUNTY OF INGHAM

Administrative Order 1988-3

IN THE MATTER OF:
JONES AND LAUGHLIN CASES

At a session of said Court held in the City of Lansing, Ingham County, Michigan, on the 4th day of March, 1988.

Present: Honorable MICHAEL G. HARRISON, Chief Judge

There pending in the Court of Claims in excess of 200 matters relating to what have become known as "Jones and Laughlin" type cases and the Michigan Court of Appeals having certified a conflict to the Michigan Supreme Court in its recent decision of *Trinova Corp* v *State of Mich*, —— Mich App ——, (1988),

IT IS HEREBY ORDERED that all such matters are held in abeyance pending a determination by the Supreme Court on the application for leave to appeal in *Trinova*.

IT IS FURTHER ORDERED that all such matters be removed from the active case load of the Court of Claims until further order.

/s/ Michael G. Harrison
MICHAEL G. HARRISON
Chief Circuit Judge